PAGE

Colorado v. United States, 271 U.S. 153 (1926) 53
Continental Illinois Nat. Bank v. Chicago, Rock Island & Pac. R. R., 294 U.S. 648 (1935) 106, 107

Denver & Rio Grande R.R. Co. v. United States, 387 U.S. 485 (1967) 152

Ecker v. Western Pac. R.R., 318 U.S. 448 (1943) 151

House of Lord's Inc., 3 Trade Reg. Rep. Par. 17,437 (F.T.C. 1966) 39

In re Larsen, 17 N. J. Super. 564, 86 A. 2d 430 (App. Div. 1952) 46
In re New York, N.H. & H.R.R., 281 F.Supp. 65 (D. Conn. 1968) 18, 104
In re New York, New Haven & H. R.R. Co. (Chase Manhattan Bank v. Smith), 378 F. 2d 635 (2d Cir. 1967) 111
In re New York, New Haven & Hartford R.R. Co., 289 F. Supp. 451 (D. Conn. 1968) ..... *passim*
In re New York, New Haven & Hartford R.R. Co., 304 F. Supp. 793 (D. Conn. 1969) ..... *passim*
In re Third Avenue Transit Corp., 198 F. 2d 703 (2d Cir. 1952) 107

Jay Street Connecting R.R. Abandonment, 307 I.C.C. 137 (1959) 55

Kilsheimer v. Rose & Moskowitz, 257 F.2d 242 (2d Cir. 1958 77

Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555 (1935) 56, 57, 107

Matter of City of New York (Fifth Ave. Coach Lines), 18 N.Y. 2d 220, 273 N.Y.S. 2d 52 (1966) 115
McCandless v. United States, 298 U.S. 342 (1936) 151

PAGE

New York Central R.R. Co. Acquisition of Boyne City, G & A R.R., 180 I.C.C. 538 (1932) 55
New York Central R.R. Co. Acquisition of Chicago, Attica & Southern R.R. Co., 187 I.C.C. 527 (1932) 55
New York Central R.R. Co. v. New York, New Haven & Hartford R.R. Co., 24 Misc. 2d 414, 208 N.Y.S. 2d 605 (1960) (lower court Biltmore Case) 120
New York Central R.R. Co. v. New York, New Haven & Hartford R.R. Co., 13 A.D. 2d 309, 216 N.Y.S. 2d 928 (1st Dept. 1961), aff'd mem. 11 N.Y. 2d (1962) (Biltmore Case) 120
New York, New Haven & Hartford R.R. Co. First Mortgage 4% Bondholders Committee v. United States, 289 F. Supp. 418 (S.D.N.Y. 1968) ..... *passim*
New York, N.H. & H.R.R.—Discontinuance of Passenger Trains, 327 I.C.C. 151 (1966) 5, 13, 16, 69, 103
New York, N.H. & H.R.R. Loan Guaranty, 312 I.C.C. 471 (1961) 75
New York, Ontario, and Western Railway Co. Case (F.D. 19861, Oct. 10, 1957) 77

Oscar Gruss & Son v. United States, 261 F. Supp. 386 (1966) remanded, 386 U.S. 776 (1967) 14, 59, 60

Pacific Telephone & Telegraph Co. v. Tax Commission, 297 U.S. 403 (1936) 53
Penn-Central Merger and N & W Inclusion Cases, 389 U.S. 486 (1968) 14, 37, 50, 54, 59, 74, 110
Pennsylvania R.R.-N.Y. Central R.R.—Merger, 327 I.C.C. 475 (1966) (Penn Central Merger Case) 4, 5, 16, 17, 36, 40, 42
Pennsylvania R.R.-N.Y. Central R.R.—Merger—Second Supplemental Report, 331 I.C.C. 643 (1967) (Inclusion Report) ..... *passim*
Pennsylvania R.R.-N.Y. Central R.R. — Merger — Fourth Supplemental Report, 334 I.C.C. 25 (1968) (Remand Report) ..... *passim*

PAGE

Pennsylvania R.R.-N.Y. Central R.R.—Merger—Fifth Supplemental Report on Reconsideration, 334 I.C.C. 528 (1969) ..... *passim*
Port Authority Trans-Hudson Corp. v. Hudson-Rapid Transit Tubes Corp., 20 N.Y. 2d 457, 285 N.Y.S. 2d 24 (1967), *cert. denied*, 390 U. S. 1002 (1968) 115, 116, 126, 127
Protective Committee for Independent Stockholders v. Anderson, 390 U.S. 414 (1968) 122

Railroad Commission of Texas v. Eastern Texas Railroad, 264 U.S. 79 (1924) 51, 53, 54, 66
Reconstruction Finance Corp. v. Denver & Rio Grande R. Co., 328 U.S. 495 (1946) 70

St. Joe Paper Co. v. Atlantic Coast Line R.R., 347 U.S. 298 (1954) 37
Tennessee Central Railway Co. Abandonment, 333 I.C.C. 443 (1968) 54, 55, 75, 76

Wright v. Mountain Trust Bank, 300 U.S. 440 (1937) .. 107

Zirn v. Hanover Bank, 215 F. 2d 63 (2d Cir. 1954) 82

Constitutional Provisions:

Constitution of the United States, Art. 1, Sec. 8 par. 4 106
Fifth Amendment to the Constitution of the United States 6, 8, 10, 11, 27, 51, 57

PAGE

Statutes:

Administrative Procedure Act, 5 U.S.C.:
- Section 702 6
- Section 704 6
- Section 706 6

Bankruptcy Act, 11 U.S.C.:
- Section 205(b) 6
- Section 205(e) 6
- Section 205(g) 6
- Section 205(o) 6

Interstate Commission Act, 49 U.S.C.:
- Section 1(4) 147
- Section 1(9) 147
- Section 1(18) ..... *passim*
- Section 1(20) ..... *passim*
- Section 5(2) 6, 8, 10, 11, 50

Miscellaneous:

Black, The Bill of Rights, 35 N.Y.U.L. Rev. 865 (1960) 57

Elman, A Note on Administrative Adjudication, 74 Yale L.S. 652 (1965) 39

Jaffe, Administrative Law: Burden of Proof and Scope of Review, 79 Harv. L. Rev. 914 (1966) 46

Jaffe, Judicial Control of Administrative Action (1965) 39

IN THE

Supreme Court of the United States

October Term, 1969

Nos. 914, 915, 916, 917, 920, 921, 1038, 1057

THE NEW YORK, NEW HAVEN AND HARTFORD RAILROAD COMPANY FIRST MORTGAGE 4% BONDHOLDERS COMMITTEE, MANUFACTURERS HANOVER TRUST COMPANY, as Trustee of the First and Refunding Mortgage of the New York, New Haven and Hartford Railroad Company, and THE CHASE MANHATTAN BANK, N. A., as Trustee under the General Income Mortgage of the New York, New Haven and Hartford Railroad Company,

Appellants-Petitioners-Respondents,

v.

UNITED STATES OF AMERICA, INTERSTATE COMMERCE COMMISSION and PENN CENTRAL COMPANY,

Appellees-Respondents-Petitioners.

On Appeals from the United States District Court for the Southern District of New York and on Writs of Certiorari to the United States Court of Appeals for the Second Circuit

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BRIEF FOR THE NEW YORK, NEW HAVEN AND HARTFORD RAILROAD COMPANY FIRST MORTGAGE 4% BONDHOLDERS COMMITTEE, APPELLANT-PETITIONER-RESPONDENT

The New York, New Haven and Hartford Railroad Company First Mortgage 4% Bondholders Committee (Bondholders Committee) appeals from the decree of the

three judge United States District Court for the Southern District of New York (Statutory District Court) entered on September 11, 1969, modifying and sustaining as modified the Fourth Supplemental Report and Order of the Interstate Commerce Commission (Commission) dated November 25, 1968 (Remand Report), which report incorporates and adopts, except where expressly modified, the Second Supplemental Report of the Commission dated November 16, 1967 (Inclusion Report).

The Bondholders Committee also appeals from the orders of the United States District Court for the District of Connecticut (Reorganization Court)* dated August 10, 1968 and July 1, 1969, and Part I of the order dated July 28, 1969.

Appeals from the September 11, 1969 decree of the Statutory District Court were filed by the Bondholders Committee (No. 915), Manufacturers Hanover Trust Company as Trustee (No. 917), and Chase Manhattan Bank N.A. as Trustee (No. 921). Petitions to this Court for the issuance of writs of certiorari to the United States Court of Appeals for the Second Circuit before judgment in respect of the August 10, 1968, July 1, 1969 and July 28, 1969 orders of the Reorganization Court were filed by the Bondholders Committee (No. 914), Manufacturers Hanover

* The New Haven is and has been a debtor in reorganization under Section 77 of the Bankruptcy Act since July 7, 1961. The reorganization proceedings have been assigned for all purposes to United States Circuit Judge Robert P. Anderson. Judge Anderson was a United States District Judge in 1961 and became a United States Circuit Judge in 1964. He has retained jurisdiction over the proceedings by designation of the Court of Appeals for the Second Circuit.

Trust Company as Trustee (No. 916), Chase Manhattan Bank N.A. as Trustee (No. 920), Penn Central Company (No. 1038), and the United States and Interstate Commerce Commission (No. 1057).*

By order of this Court dated February 2, 1970, probable jurisdiction was noted in Nos. 915, 917 and 921 and the petitions for certiorari were granted in Nos. 914, 916, 920, 1038 and 1057, and all of the said cases were consolidated for argument upon an expedited schedule.

Opinions Below

The Statutory District Court issued its opinion in this case on June 18, 1969. The opinion is not yet reported and has been reprinted at pages 400a-443a of the Appendix of Decisions** filed in connection with the jurisdictional statements filed on behalf of the appellants. The opinion was supplemented by a memorandum dated September 11, 1969, which memorandum is not yet reported and has been reprinted at pages 444a-445a of the Appendix of Decisions.

* The New Haven Trustees and the States of New York and Connecticut did not appeal from the decrees of either court.

** The opinions below are separately bound in an Appendix of Decisions and Constitutional and Statutory Provisions entitled "The New Haven Railroad Terms of Sale and Inclusion Cases" filed in connection with the Jurisdictional Statements. References to that appendix are identified by the letter "a" following the page reference.

References preceded by "NHI" or "R" are to consecutively numbered exhibits at hearings before the Commission's Examiners; references preceded by "Tr." are to pages of the transcript of the Commission hearings; references preceded by "Spec. M. Rep." are to pages of the Special Master's Report; references preceded by "Cert. R. Doc. #" are to the document numbers of the original record filed in connection with the petitions for certiorari (No. 914); references preceded by "R. Doc. #" are to the document numbers of the original record filed in connection with the appeals (No. 915); references followed by "b" are to pages of the single appendix filed under Rule 36.

The final decree of the Statutory District Court dated September 11, 1969, has been reprinted at pages 446a-452a of the Appendix of Decisions.

The Reorganization Court issued its opinion in this case on May 28, 1969. The opinion is reported at 304 F. Supp. 793 and has also been reprinted at pages 277a-306a of the Appendix of Decisions. A supplementary opinion dated July 28, 1969 has been reported at 304 F. Supp. 1121 and a portion of that opinion has been reprinted at pages 312a-315a of the Appendix of Decisions. The order of the Reorganization Court dated July 28, 1969, has been reported at 304 F. Supp. 1136 and has been reprinted commencing at page 312a. The orders dated May 28 and July 1, 1969, have been reprinted commencing at page 307a and page 309a of the Appendix of Decisions.

The opinion of the Statutory District Court which resulted in the remand of the Inclusion Report is reported at 289 F. Supp. 418 (S.D.N.Y. 1968) and has been reprinted at pages 323a-383a of the Appendix of Decisions. The opinion of the Reorganization Court which remanded the Inclusion Report is reported at 289 F. Supp. 451 (D. Conn. 1968) and has been reprinted at pages 237a-260a of the Appendix of Decisions.

The Commission has rendered two decisions on the price to be paid for the New Haven assets which have been set forth in a series of supplemental reports to the basic merger case *Pennsylvania R.R.-Merger-New York Central R.R. Co.*, 327 I.C.C. 475 (1966) (*Penn Central Merger Case*). The first is embodied in the Second Supplemental Report, dated November 16, 1967, referred to as the Inclu-

sion Report, is reported at 331 I.C.C. 643 and reprinted at pages 1a-111a of the Appendix of Decisions. After the remand by the two reviewing courts, the second decision on price was embodied in the Fourth Supplemental Report, dated November 25, 1968, refferred to as the Remand Report, is reported at 334 I.C.C. 25 and reprinted at pages 112-220a of the Appendix of Decisions. The Commission has also issued a "Fifth Supplemental Report On Reconsideration", dated July 10, 1969 as modiffied August 26, 1969, is reported at 334 I.C.C. 528 and reprinted at pages 222a-228a of the Appendix of Decisions.* Simultaneously with the issuance of the *Penn Central Merger Case* report the Commission issued its report in *New York, N.H. & H.R.R. Co.—Discontinuance of All Passenger Trains,* 327 I.C.C. 151 (1966) (New Haven Passenger Discontinuance Case).

Jurisdiction

The decree of the Statutory District Court appealed from was entered on September 11, 1969. Notice of appeal to this Court from that decree was filed in said District Court by the Bondholders Committee on October 9, 1969.

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* The Fifth Supplemental Report on Reconsideration dated July 10, 1969 was issued *ex parte* and on the Commission's "own motion" (334 I.C.C. at 529) subsequent to the second opinions of the Reorganization Court and the Statutory District Court. Neither Court remanded any issues in respect of the price and no hearings were held by the Commission or argument of papers submitted by any party. The issuance of the July 10, 1969 report triggered a petition by Penn Central for reconsideration and a subsequent submission of briefs by the parties. The Commission, on reconsideration, modified its report and re-issued the report as modified on August 26, 1969. The Fifth Supplemental Report appears to have been issued solely in response to the request of the Statutory District Court for the submission of a proposed decree (p. 431a). The Statutory District Court's decree recites that it was "advised" by the Fifth Supplemental Report (p. 447a).

The judgment of the Reorganization Court appealed from was dated and entered on July 28, 1969. The Bondholders Committee filed a notice of appeal to the Court of Appeals for the Second Circuit on August 26, 1969. The Record on Appeal was timely docketed in the Court of Appeals for the Second Circuit on December 2, 1969.* No briefs have been filed in the Court of Appeals and the case has not been heard or decided by that Court.

The jurisdiction of this Court is invoked under Title 28, U.S.C. §§1253, 1254(1) and Rule 20 of the Rules of this Court.

Constitutional Provisions and Statutes Involved

The statutes involved in this case are: Fifth Amendment to the Constitution of the United States; Administrative Procedure Act, §§10(a), 10(c), 10(e), 5 U.S.C. §§702, 704, 706; Interstate Commerce Act, §§1(18), 1(20), 5(2), 49 U.S.C. §§1(18), 1(20), 5(2); Bankruptcy Act §§77(b), 77(e), 77(g), 77(o), 11 U.S.C. §§205(b), 205(e), 205(g), 205(o). The text of these statutes is reprinted in the appendices filed in connection with the jurisdictional statements.

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* The time of the parties to docket the appeal had been extended by the Court of Appeals until December 15, 1969.

Questions Presented

1. Where for seven and one-half years the Reorganization Court and the Commission have required the erosion of over $70 million of the bondholders' security for the benefit of the public with the knowledge that the New Haven could not be reorganized as an operating railroad because its income could not equal its operating expenses, does the requirement of the Reorganization Court and the Commission that the New Haven transfer its properties for a price determined by the liquidation (scrap) value of the properties without compensation for the amounts expended for the public benefit work an unconstitutional taking of the bondholders' property?

2. By the consummation of its merger with knowledge that permission to merge had been conditioned upon payment of a price fair and equitable to the New Haven, has Penn Central perforce accepted to pay an amount at least equal to liquidation value plus the erosion incurred by the New Haven in consequence of the Commission's and Reorganization Court's requirement that the New Haven's passenger and freight operations continue until the date fixed by the Commission for the transfer of the property?

3. Does a price based upon liquidation value without compensation for the losses incurred by the New Haven because all of its operations were required to be continued by the Reorganization Court and the Commission after the Trustees had reported that the New Haven could not be reorganized as an operating railroad satisfy the requirement of fairness and equity referred to in Section 77 of the

Bankruptcy Act, Section 5(2)(d) of the Interstate Commerce Act or condition 8 to the Penn Central merger?

4. Has the Commission violated the Fifth Amendment to the Constitution of the United States, Section 5(2) of the Interstate Commerce Act or Section 77 of the Bankruptcy Act in requiring the transfer of the New Haven assets to Penn Central for a price less than the fair market price that could be achieved upon liquidation sales?

5. Where the Reorganization Court has used to the full its power to require the New Haven to operate at a loss in order to accommodate a Commission prescription designed to accomplish continued operations and thereby imposed the maximum erosion of the New Haven assets it held the Constitution would permit, may the Commission deduct an additional discount of $15,386,000 for lengthy delays in issuance of a certificate of abandonment?

6. Has the Statutory District Court (Weinfeld, J., dissenting) erred in concluding that the Commission's powers to issue and condition certificates for abandonment under Sections 1(18) and 1(20) of the Interstate Commerce Act in the circumstances of this case permit it to project a requirement for lengthy administrative proceedings which would set back the receipt of liquidation proceeds for one year and to discount the fair market value of the assets on account of the hypothetical delay? Should the Reorganization Court be affirmed in its rejection of the Commission's deduction of $15,386,000 from the net liquidation value determined by the Commission as arbitrary and capricious and imposing an unconstitutional taking of

the bondholders' property for the benefit of Penn Central in the name of the public interest?

7. Does the alleged power of the Commission to designate a purchaser, in the circumstances referred to in question 5 above, include the power to require a sale at a discount from the price the New Haven would receive if the power were not exercised?

8. Has the Statutory District Court (Weinfeld, J., dissenting) erred in concluding that the Commission's powers to issue and condition certificates for abandonment under Sections 1(18) and 1(20) of the Interstate Commerce Act in the circumstances of this case permit it to require a sale of the assets to a single intermediate purchaser for liquidation at a discount from fair market value which reflects the costs and profits of the intermediate purchaser when the Reorganization Court has held that such a sale would be improvident and would not be approved by it? Should the Reorganization Court be affirmed in its rejection of the Commission's deduction of $6,695,000 from the net liquidation value determined by the Commission as arbitrary and capricious and as imposing an unconstitutional taking of the bondholders' property for the benefit of Penn Central in the name of the public interest?

9. Have the Commission and the Courts (Weinfeld, J., dissenting) erred in concluding that payment of a substantial portion ($83.1 million) of the minimum price required by the Constitution is satisfied by the delivery of shares of Penn Central common stock having a market value of $60.21 million on the date of the transfer of the assets and

a value of $50.35 million of even date with the valuation of the assets, if supplemented by an unsecured undertaking by Penn Central to pay on February 1, 1978 the difference between $83.1 million and the then market value of the shares?

10. Have the Courts erred in failing to hold that the Commission violated the Fifth Amendment, Section 5(2) of the Interstate Commerce Act or Section 77 of the Bankruptcy Act in requiring the transfer of the New Haven's right to receive $5.6 million annually from the Grand Central Terminal real estate and hotels, without any compensation to the New Haven for such transfer?

11. Has the Statutory District Court erred in failing to hold that the Commission violated the Fifth Amendment, Section 5(2) of the Interstate Commerce Act or Section 77 of the Bankruptcy Act in failing correctly to analyze and compute the discount to present worth of the net proceeds to be anticipated in a hypothetical liquidation? Should the Reorganization Court be affirmed in its addition of $2,415,899 to the price to effect its correction of the Commission's computation of the discount to present worth of the hypothetical net proceeds?

12. Has the Statutory District Court (Weinfeld, J. dissenting) erred in failing to hold that the Commission violated the Fifth Amendment, Section 5(2) of the Interstate Commerce Act or Section 77 of the Bankruptcy Act in valuing the New Haven's Harlem River and Oak Point freight yards at less than their highest and best use? Should the Reorganization Court be affirmed in its finding that the Commission was arbitrary and capricious in rejecting the evidence that the minimum value of the freight

yards was $4.439 million more than the figure set by the Commission?

13. Have the Courts erred in failing to hold that the Commission violated the Fifth Amendment to the Constitution of the United States or Section 77 of the Bankruptcy Act in requiring the transfer to Penn Central of certain securities owned by the New Haven, without any compensation to the New Haven for such transfer?

14. Have the Courts (Weinfeld, J. dissenting) erred in failing to hold that the Commission violated the Fifth Amendment, Section 5(2) of the Interstate Commerce Act or Section 77 of the Bankruptcy Act in failing to require Penn Central to assume the full operating losses incurred by the New Haven between February 1, 1968 and December 31, 1968?

15. Where the Commission and the Courts have required the New Haven to continue deficit operations without interruption until the Penn Central merger was effected and Penn Central assumed the service and where the Commission imposed upon Penn Central, as merger applicants, the requirement that the applicants, after merger, operate the service of the New Haven and pay a fair and equitable price for the assets, is a price fixed without assignment of value to the intangible going concern values which permit Penn Central to continue the service without interruption fair and equitable?

16. Have the Courts erred in accepting valuations arrived at by the Commission in violation of the due process rights of the bondholders where the Commission improp-

erly tailored its findings and conclusions to suit its design for the national transportation policy and subordinated to that design its obligation to adjudicate the evidence impartially?

17. Under all the circumstances, has the Statutory District Court erred in modifying and sustaining the Fourth Supplemental Report and Order as modified? Under all the circumstances, has the Reorganization Court erred in modifying and approving the Fourth Supplemental Report and Order as modified?

Statement

The New Haven is and has been a Debtor in reorganization under Section 77 of the Bankruptcy Act in the United States District Court for the District of Connecticut since July 7, 1961. The Bondholders Committee has been authorized to represent holders of the New Haven's First and Refunding Mortgage Bonds in the reorganization proceedings since February 5, 1962. As of December 31, 1968, the holders of the First Mortgage Bonds have outstanding claims totalling $101,659,900, consisting of $76,819,900 for principal and $24,840,000 for interest.

Description of the New Haven Railroad

This Court has described the New Haven as "* * * the sixth largest railroad in the Northeastern Region and the largest in New England. On a national basis it ranks fourth among passenger-carrying railroads and is one of the largest nontrunk line freight roads. It has some 1500

miles of railroad in four States—Massachusetts, Rhode Island, Connecticut, and part of New York." *Baltimore & Ohio R. Co.* v. *United States,* 386 U.S. 372, (1967).*

As of December 31, 1961, the book value of the New Haven's assets was $420,204,954. *New Haven Passenger Discontinuance Case,* 327 I.C.C. at 231. As of December 31, 1965, the book value was $395,596,468 and as of December 31, 1966 the book value was $380,588,469. *Inclusion Report,* 331 I.C.C. at 747; p. 105a.**

An estimated 30,000 persons use the New Haven's service to commute daily between Westchester County, New York, southern Connecticut and New York City. Approximately 25,000,000 revenue passengers are accommodated annually by the New Haven service. *New Haven Passenger Discontinuance Case, supra,* at 168-169.

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* In the *New Haven Passenger Discontinuance Case,* 327 I.C.C. 151 (1966), the Commission described the New Haven Railroad as follows: "The New Haven is a class I line-haul railroad engaged in the transportation of freight and passengers in the States of New York, Connecticut, Massachusetts and Rhode Island. It is the largest railroad in this territory. Its service area extends from New York to Boston via New Haven, New London and Providence, with important branches to Maybrook, N. Y., Waterbury and Hartford, Conn., and Springfield, Mass.; its service area includes 12 cities, each with populations greater than 100,000, and a number of important defense establishments.

The New Haven handles about one-third of all rail freight in New England; ranking 28th in size nationally among all class I railroads in terms of freight revenues. It connects with 9 other class I railroads throughout various points in New York, Connecticut, and Massachusetts. In 1964 there were 62 railroads furnishing rail passenger service in the nation. Among them, the New Haven ranked third as to passengers riding on other than commutation and multiple ride tickets. In passenger revenues, it was fourth highest in the United States." 151 I.C.C. at 163.

** The book value did not reflect the value of New Haven's interest in the income from the Grand Central Terminal properties. See pages 118-130, *infra.*

Historically, the New Haven was closely allied to Penn and the Penn-New Haven connections served as the major competition for the Central in the New England area. See *Oscar Gruss & Son* v. *United States,* 261 F. Supp. 386, 389 (S.D.N.Y. 1966), remanded, 386 U. S. 776 (1967).

Description of Penn Central:

This Court has described Penn Central as follows:

> "The Pennsylvania and the New York Central dominate rail transportation in the Northeast. Their freight operations extend over 20,000 miles of road in 14 States and Canada. They are the two largest passenger carrying railroads in the United States." *Penn-Central Merger and N&W Inclusion Cases,* 389 U. S. 486, 493 (1968).

The book value of the assets of Penn and Central as of November 30, 1966 (adjusted to give effect to the merger) was $4,271,650,806 with a shareholders' equity of more than $2.4 billion. *Inclusion Report,* 331 I.C.C. at 479; p. 107a. The savings from the Penn-Central merger have been projected at $80 million annually. *Penn Central Merger and N&W Inclusion Cases, supra,* at 493.

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The New Haven Trustees (Trustees), during the first six months of the trusteeship, acknowledged* that the anticipated income of the New Haven would not meet its expenses even without regard to fixed charges on bonded indebtedness.

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* The Trustees' brief in response to the petitions for certiorari to this Court, filed December 12, 1969 (Nos. 914, 916, 920) stated at page 6: "From the outset of the New Haven's reorganization, it was acknowledged by the Reorganization Court and the Trustees that survival of a major transportation system was at stake. However, with

On March 9, 1962, Penn and Central jointly filed their application with the Commission for authority to merge Central into Penn. The Trustees, on June 26, 1962, opposed the Penn Central merger unless the New Haven was included in the transaction. The Trustees did not file proposed terms of inclusion and the Penn-Central merger record before the Hearing Examiners was closed July, 1963.

In June, 1964, the Trustees and Penn and Central commenced secret negotiations toward a sale of the New Haven assets to Penn Central. After four meetings, a basic Memorandum of Agreement was signed in December, 1964, but was not announced. Only after the signing of the memorandum did the Trustees, on January 15, 1965, petition the Reorganization Court for authority to apply to the Commission for authorization to discontinue all passenger service. (The negotiations and agreement with Penn Central were not disclosed.) The Reorganization Court granted the requested authority by Order Number 287, dated February 15, 1965. In March, 1965, the Trustees filed the discontinuance application with the Commission.

On March 29, 1965, the Hearing Examiners' report in the Penn Central merger case was issued. It provided for operation by Penn Central of only the New Haven's freight service. Since the Trustees had presented no evidence on the question of fair and equitable terms, none were recom-

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operations producing a substantial deficit in income available for fixed charges, an internal reorganization of the traditional type involving recapitalization of the corporate debt structure was clearly an inadequate device."

mended. Only then, on March 31, 1965, did the Trustees reveal the hitherto secret agreement with Penn Central for the sale of New Haven assets to Penn Central and the consideration to be received. The formal agreement was executed on April 21, 1966 (Agreement).* The Trustees never sought and have never received authorization to sign the Agreement and the Reorganization Court has never approved its terms.**

The Commission, with knowledge of the Agreement, simultaneously decided the *New Haven Passenger Discontinuance Case, supra,* and the *Penn Central Merger Case,* 327 I.C.C. 475 (1966). It denied the passenger discontinuance on the basis of its merger decision which required Penn Central to purchase the New Haven assets and continue the passenger and freight operations as a merger condition.

The Commission required the filing of an agreed upon plan covering the terms and conditions of inclusion within six months and then stated:

> "In the event the parties concerned do not reach an agreement and file such a plan within said period, we shall, upon due notice to all parties in the instant proceeding, undertake whatever procedure we then deem appropriate to establish the terms and conditions for inclusion of the New Haven. Consummation of the merger by applicants shall indicate their full and complete assent to these requirements. With regard to the trustees of the New Haven Railroad, *their assent,* we recognize *is also subject to appropriate procedures of*

* For the Agreement's principal terms, see p. 60, *infra.*

** When, for the first time, the terms of the Agreement were submitted to the Reorganization Court for approval by the Inclusion Report, the Reorganization Court rejected the terms.

approval in the United States District Court under the Bankruptcy Act." *Penn Central Merger Case, supra,* at 527.* (Emphasis added.)

In October, 1966, the Trustees and Penn Central amended the Agreement to reflect the assumption of both freight and passenger operations.

On October 27, 1966, Penn Central filed its petition for approval of the Agreement as a plan of inclusion and the Trustees filed the identical plan as the "first step" of a plan of reorganization. The filing of the proposal did not indicate "assent" to the proposed terms and conditions by the Reorganization Court or the bondholders.

Hearings on these petitions were held before a Hearing Examiner and concluded on May 12, 1967. By Commission order, a report or recommended decision of the Hearing

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* See second footnote, page 16, *supra.*

The formal condition fixed by the Commission ("condition 8") is as follows:

"8. The Pennsylvania New York Central Transportation Company shall be required to include in the transaction all the New York, New Haven and Hartford Railroad Company—the inclusion of passenger operations being subject to the findings and determinations of the Commission as set forth in Finance Docket No. 23831 issued simultaneously with this report—upon such fair and equitable terms as the parties may agree subject to the approval of the Bankruptcy Court and the Commission. Within 6 months after the date this report is served, the parties shall file with the Commission for its approval, a plan for such inclusion. In the event the parties are unable to reach an agreement (and subject to approval by the Bankruptcy Court) such inclusion shall be upon such fair and equitable terms and conditions as the Commission may impose. * * * Jurisdiction is hereby reserved for such purposes. Consummation of the merger by applicants shall indicate their full and complete assent to these requirements." (*Penn Central Merger Case,* 327 I.C.C. at 553)

Examiner was omitted and the record was submitted to the Commission on July 17, 1967 for initial decision.

Even before completion of the hearings, by a cross-petition dated April 26, 1967 filed in the Reorganization Court, the Bondholders Committee sought the termination of the reorganization proceedings to permit liquidation of the New Haven assets. On February 1, 1968, Penn and Central merged. Only on February 13, 1968 did the Reorganization Court dismiss the cross-petition. *In re New York, N.H. & H. R.R.*, 281 F. Supp. 65 (D. Conn. 1968); p. 229a.

While the cross-petition was *sub judice*, the Reorganization Court, by a "Partial Ruling" on July 11, 1967, suggested the Commission require Penn Central to assume by lease the operations of the New Haven simultaneously with consummation of the merger. On August 1, 1967, the Commission ordered the Trustees and Penn Central to file an agreement providing for operation of the New Haven by lease, within 30 days, or, in the absence of such agreement, to file their respective proposals for terms of a lease. The order was frustrated when Penn Central and the Trustees rejected the order as not feasible.

To avoid the imminent closing of New Haven operations by erosion of cash, which prompted the Reorganization Court's "Partial Ruling", the Trustees, on September 1, 1967, filed a proposal under which Penn Central, after merger would lend $25 million, assume operating losses of the New Haven between the merger and the sale of the assets, and be repaid its loan by an offset against the pur-

chase price. Concurrently, Penn Central filed a separate proposal to lend $25 million over three years.

By order dated September 12, 1967, the Commission changed its August 1, 1967 Order and set September 25, 1967 for hearings before a Hearing Examiner on the question of an "appropriate arrangement" for support of New Haven operations. These hearings resulted in that part of the Inclusion Report that has been referred to as the "loan-loss formula", thereafter condemned by all courts for its *in terrorem* provision. See page 110, *infra*.

While the proceedings were pending before the Commission and the Reorganization Court, the Bondholders Committee requested this Court to enjoin consummation of the Penn Central merger unless and until the feasibility of inclusion was finally assured.*

After the filing of the jurisdictional statement, but prior to argument before this Court, the Commission issued its Inclusion Report and furnished copies to this Court. Both the Commission and Penn Central reassured this Court that consummation of the merger would eliminate any claim of unfairness by them even if the price was finally adjusted upward. This Court denied the Bondholders

* The Bondholders Committee predicted in its Jurisdictional Statement filed November 17, 1967 in case number 831, October Term, 1967:

> "It is entirely possible that the Commission will not require Penn-Central to pay the equivalent of the liquidation value of the New Haven. If that is the case, when an approved plan of reorganization is forwarded from the Commission to the Reorganization Court in accordance with Section 77 of the Bankruptcy Act, it can be expected that the Reorganization Court will recognize that a sale of the New Haven for less than its liquidation value would effect an unconstitutional taking of property."

committee's request to enjoin the Penn Central merger, stating

> "The bondholders agree that to delay the Penn-Central merger until all proceedings necessary to include the NH had taken place may well mean the end of NH operations. The only realistic way to avoid this is to permit prompt consummation of the Penn-Central merger, subject to appropriate conditions respecting the New Haven which Penn-Central will perforce accept by its act of merger. While the rights of the bondholders are entitled to respect, they do not command Procrustean measures. They certainly do not dictate that rail operations vital to the Nation be jettisoned *despite the availability of a feasible alternative.*" (389 U.S. at 510-11) (emphasis added)

Judicial review of the Inclusion Report and orders then proceeded in both a statutory three-judge District Court for the Southern District of New York and the Reorganization Court.* Both courts found that the Commission had committed numerous errors and both remanded the proceedings to the Commission. *New York, N.H. & H. R.R. First Mortgage 4% Bondholders Committee* v. *United States,* 289 F. Supp. 418 (S.D. N. Y. 1968); p. 323a;** *In re*

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* The decision of the Statutory District Court sustaining the parallel review proceedings is reprinted at 289 F. Supp. at 424 fn. 3 (p. 325a).

** Judge Weinfeld catalogued the errors as follows: "(1) the Commission's failure to discount New Haven's liquidation expenses over the projected six year liquidation period, 289 F. Supp. at 427-28; (2) its miscalculation of New Haven's right to surplus income from the Grand Central Terminal properties, *id.* at 428-33; (3) its ambiguous valuation of the Harlem River and Oak Point freight yards, *id.* at 433-34; (4) its erroneous valuation of New Haven's interest in the Boston & Providence Railroad, *id.* at 434-35; (5) its failure to discount the 5% bonds with which Penn Central was to meet its obligations under the Purchase Price Adjustments, *id.* at 437-38; (6) its error in deducting from the amount to be paid to

New York, N. H. & H. R. R. Co., 289 F. Supp. 451 (D. Conn. 1968); p. 237a.*

In remanding the Inclusion Report to the Commission for the correction of its many errors, the Reorganization Court also held that the continuation of the New Haven's deficit railroad operations after December 31, 1968 would stretch the subjection of the New Haven's creditor's rights to the public interest beyond constitutional limits.**

New Haven the sum of outstanding real estate tax liens, *id.* at 438; (7) its failure to indicate the source of its estimate of 1966 depreciation of New Haven properties, set forth in its brief before us but not in its Inclusion Report, *id.* at 438; (8) its miscalculation of the cost to Penn Central of Penn Central's 5% bonds, its assumption of New Haven's obligations under the Boston & Providence mortgage, and its payment under the Purchase Price Adjustments, *id.* at 439; (9) the Commission's failure to take into account a reduction in 1966 New Haven equipment obligations, *id.* at 439 n. 15; (10) its conclusion that Penn Central would assume overmortgaged New Haven equipment, *id.* at 439; (11) its failure to include any of Penn Central's absorption of New Haven's interim operating losses in the category of the cost of acquisition to Penn Central, *id.* at 440; (12) its use of a sliding-scale formula for Penn Central's interim loss-sharing as a device to curtail litigation by the New Haven bondholders, *id.* at 444; and (13) its tendency to 'round off' sums, with a consequent loss of some $5.3 million to the New Haven estate, *id.* at 427." (p. 432a, fn. 2).

* Prior to its decision, the Reorganization Court had appointed the Honorable John Van Voorhis, a retired Judge of the New York Court of Appeals, as a Special Master to hear and report on the questions relating to the New Haven's right, title or interest in the Grand Central Terminal properties (the entire land area extending roughly from 42nd Street to 53rd Street and between Madison and Lexington Avenues, in the heart of New York City). Special Master Van Voorhis held hearings on July 8, 1968 through July 13, 1968 and the record of those hearings were incorporated into the record before the Commission. The Special Master filed his main report on June 18, 1968 and a supplemental report on July 22, 1968. The reports of the Special Master have been reprinted in the single appendix.

** The Reorganization Court inferentially held that imposition of the erosion in an uncertain amount to December 31, 1968 did not exceed constitutional limits. The argument that the Reorganization Court erred in this conclusion appears at pages 102-109, *infra.*

Hearings on the issues remanded to the Commission were completed on October 15, 1968.* The Commission issued its Remand Report on November 25, 1968. It ordered the binding tranfer of the New Haven assets to Penn Central, free and clear of the liens, but without prejudice to continued litigation on the question of price in order, in the "public interest", to require "the continuation of the NH service without interruption" (334 I.C.C. at 76; p. 163a).

By order dated December 24, 1968 (p. 269a), the Reorganization Court ordered the transfer of substantially all of the assets of the New Haven, free and clear of all liens, but without prejudice to the right of any party to contest the fairness and adequacy of the consideration (p. 275a). On that basis, the transfer of assets took place at midnight December 31, 1968 and, in accordance with the public interest declaration of the Commission, the New Haven's railroad operations were continued without interruption.

Penn Central's applications to enjoin the December 31, 1968 takeover were denied by the Reorganization Court and the Statutory District Court (pp. 263a, 387a).

Judicial review of the Remand Report, which adopts and reaffirms the Inclusion Report, except where expressly modified, again proceeded in both the Statutory District Court and the Reorganization Court.

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* By Commission order, a report or recommended decision of the Hearing Examiner was omitted and the record was presented to the Commission for initial decision. Requests for oral argument before the Commission were denied.

The Reorganization Court held that Step 1 of the plan as contained in the Remand Report was deficient. It cited and corrected specific errors of the Commission as follows:

> "1. The sums of (a) $15,386,000 as a consequence of possible delay in abandonment and (b) $6,695,000 as a bulk sales discount should not be deducted from the Commission's finding of liquidation value;
>
> "2. The value of the Harlem River and Oak Point Freight Yards is $22.539 million, which is an increase of $4.439 million over the amount found by the Commission;
>
> "3. The sum of $1.6 million should be added to liquidation value inasmuch as it was improperly deducted in respect of tax obligations;
>
> "4. The sum of $1.5 million should be deducted from the liquidation value inasmuch as it was improperly attributed to the so-called 'CCBIs' to be issued by Boston and Providence Railroad Corporation;
>
> "5. The sum of $2,415,899 should be added to liquidation value inasmuch as it was improperly deducted in applying the discount to present value found by the Commission; and
>
> "6. The value of the 950,116 shares of common stock delivered by Penn Central on December 31, 1968 to the Debtor is $83.1 million, subject to the provisions hereinafter set forth in ordering Paragraph B [guaranteeing payment of $87.50 per share]." (304 F.Supp. 1136, 1137-8; p. 318a)

It also held that the Commission was in error in failing to find that Penn Central was indebted to the New Haven in the amount of $3,377,903.07 on account of past Grand Central Terminal debts.*

* By Supplemental Order No. 572 dated July 1, 1969, this amount was offset against a sum owed to Penn Central by the New Haven. (p. 309a).

On June 18, 1969, the Statutory District Court filed its opinion, with Judge Weinfeld dissenting in part. A decree, with an accompanying memorandum, was filed by the Statutory District Court on September 11, 1969 (p. 446a). The decree directs an addition of $990,000 to the purchase price set by the Commission in the Remand Report.

The decree (p. 449a) also provides for the payment by Penn Central of its debt of $3.38 million by way of offset as provided in the July 1, 1969 order of the Reorganization Court (Supplemental Order No. 572). (p. 309a). Both Courts rejected the Bondholders Committee's claim for interest on the amounts adjudicated to have been improperly withheld.*

The Statutory District Court computed the net increase of $990,000 as follows:

> "1. An increase of $1,600,000 representing an adjustment in the treatment of accrued real estate taxes;
>
> "2. An increase of $410,000 representing an adjustment to the discount to present worth arising from decreases in valuation of properties of the New Haven Railroad;
>
> "3. An increase of $480,000 representing the amount by which the Commission overvalued the assumption by Penn Central Company of the obligations of the New Haven Railroad in respect to its Harlem River Division Bonds; and
>
> "4. A decrease of $1,500,000 representing the overvaluation of the New Haven Railroad's interest in the Boston & Providence Railroad Corp.;" (p. 448a).

* The argument that the denial of interest is improper is found at page 130, *infra*.

The Statutory District Court required the $990,000 to be paid as follows: 57.1% in Penn Central common stock, 37.4% in Penn Central Bonds and 5.5% in cash with interest at 6% from December 31, 1968 (pp. 448a-449a).

In respect of the value of the Penn Central stock delivered and to be delivered, the Statutory District Court (Weinfeld, J. dissenting), agreeing with the Reorganization Court, found that the stock did not have the value attributed to it by the Commission, absent a formula for guaranteeing the payment in 1978 of $87.50. The Statutory District Court established a formula modeled on the formula established by the Reorganization Court (pp. 449a-452a).

A catalog of the issues on which the courts differ with the Commission and each other, are as follows:*

1. "Abandonment delay discount" of $15,386,000—The Reorganization Court found the discount to be erroneous and the Statutory District Court upheld the discount, Judge Weinfeld dissenting (see page 67, *infra*).

2. "Bulk sales discount" of $6,695,000—The Reorganization Court found the discount to be erroneous and the Statutory District Court upheld the discount, Judge Weinfeld dissenting (see page 86, *infra*).

3. Harlem River and Oak Point Freight Yards—The Reorganization Court found that the Commission had made

* This appeal also involves determinations upon which the Commission and both courts have agreed, but with which the Bondholders' Committee disagrees. The rights of appeal from earlier decisions of the courts have been preserved.

an error amounting to $4,439,000. The Statutory District Court sustained the Commission, Judge Weinfeld dissenting (see page 140, *infra*).

4. Deduction of $1,600,000 for accrued real estate taxes —Both courts (the Statutory District Court unanimously) found the Commission's deduction to be erroneous.

5. Discount of net proceeds to present worth—Both courts (the Statutory District Court unanimously) held that the Commission had erred; the Reorganization Court calculated the error to be $2,415,899 and the majority of the Statutory District Court accepted the Commission's post-decision calculation of the error at $410,000 (see page 131, *infra*).

6. Value of the assumption of the Harlem River Division Bonds—The Statutory District Court unanimously held that the Commission overvalued Penn Central's assumption of these bonds by $480,000; the Reorganization Court sustained the Commission.*

7. Value of the Penn Central shares—Both courts (the Statutory District Court unanimously) found that the Commission erred in attributing a value of $83.1 million to the Penn Central shares delivered as part of the purchase price; the Reorganization Court and the Statutory District

* Since neither Penn Central, the Commission nor the United States have appealed from the Statutory District Court's determinations and the Commission adopted the view of the Statutory District Court in the Fifth Supplemental Report (334 I.C.C. at 530), this Court should affirm the Statutory District Court and the Commission on this point. The Bondholders Committee's appeal from the order of the Reorganization Court on this point is unopposed.

Court (Judge Weinfeld dissenting) required, under certain conditions, that Penn Central be obliged to pay to the New Haven the difference between the market value of the shares at February 1, 1978 and $83.1 million. Judge Weinfeld dissented on the ground that the New Haven was presently entitled to the equivalent of the property transferred (see page 95, *infra*).

8. Consideration for the transfer of the New Haven's Boston and Providence Railroad Corporation "CCBIs"—Both courts (the Statutory District Court unanimously) held that the CCBIs should be transferred to Penn Central without consideration and that the Commission erred by $1.5 million in fixing the price Penn Central should pay (see page 152, *infra*).

9. Form of payment of additional consideration—The Statutory District Court required the additional consideration to be paid in the same proportion of stock, bonds and cash as the first payment; the Reorganization Court order permits the Commission, on remand of the reorganization plan, to determine the manner and form of payment of additional consideration.

Summary of Argument

The central issue in this case is whether the price to be paid by Penn Central for the assets purchased from the New Haven, as fixed by the Commission, is fair and equitable under Section 77 of the Bankruptcy Act and provides an amount at least equal to the minimum required by the Fifth Amendment to the Constitution of the United States.

Directly related is the issue whether the consideration in the form fixed by the Commission has a value equal to the price.

I

Although the Commission undertook to find the value of the New Haven assets, it considered that it must make its findings in the light of the public interest and its responsibility to improve and nurture the national transportation system. Since on the sale of the New Haven assets the New Haven would no longer be a transportation company but Penn Central, as purchaser, would continue as a most important element in the transportation system, the Commission did not approach its judicial function impartially. The Commission identified the public interest with Penn Central's needs. The Commission considered its responsibility for the health of the transportation system permitted it to fix a low price to preserve the savings anticipated from the Penn Central merger. The extreme fashion in which the Commission favored its policy responsibilities over its judicial responsibilities requires a searching review of the Commission's findings.

II

A. The Commission's first findings of price and consideration were rejected by the reviewing courts with instructions that net liquidation value represented the constitutional minimum to which the New Haven was entitled. The Commission was therefore instructed to set the net liquidation value. The Commission, on remand, claimed the right to make, in the public interest, substantial deductions from net liquidation value. Improperly equating the

public interest with alleged considerations of fairness to Penn Central, the Commission made deductions of $22.1 million. No matter what the needs of the public may be, the Fifth Amendment to the Constitution does not permit the Commission to provide less than just compensation for the assets transferred. By its merger, Penn Central undertook to pay whatever price the Constitution required the New Haven receive as a minimum. Considerations of fairness to Penn Central were not germane.

The deduction of $22.1 million was attributed to the Commission's assertion of power to inflict expenses upon the New Haven by engaging in protracted abandonment proceedings even though the Commission was aware that the New Haven's utter collapse required prompt issuance of an abandonment certificate. The Commission also asserted a power to condition an abandonment certificate upon a discount sale to a speculator who would liquidate the assets. The Commission does not possess the powers it asserts. Its attempted exercise of those powers would be unlawful and abusive. Especially where the Reorganization Court had permitted the erosion of approximately $70 million of the bondholders' security to accommodate the avoidance of an actual liquidation, the assertion of the power to make substantial deductions from net liquidation value because of formalistic proceedings unconstitutionally deprives the bondholders of their property and is unfair and inequitable.

Even if the Commission had the power it claims, its computations of the amount of the discounts were based upon improper assumptions. The Reorganization Court

would not have approved a sale at the price the Commission considered it could impose. The Reorganization Court correctly rejected the discounts as unfair, inequitable and unconstitutional in the circumstances of this case. The Commission's attempt to instruct the Trustees as to the prudent disposition of the New Haven assets exceeded the Commission's power.

B. The Commission permitted Penn Central to discharge $83.1 million of the purchase price by the delivery of 950,000 shares of Penn Central stock which, on December 31, 1966 (the valuation date of the New Haven assets) and on December 31, 1968 (the date of the delivery of the shares), had a fair market value at least $23 million less than $83.1 million. The reviewing courts therefore correctly rejected the consideration as inadequate. The courts promulgated a formula under which Penn Central would pay to the New Haven on February 1, 1978 the difference between $83.1 million and the market value of the 950,000 shares on February 1, 1978. The formula had other refinements absolving Penn Central of responsibility to make the payment, if the shares achieved a value of $83.1 million before February 1, 1978. The formula is inadequate because a promise to pay $83.1 million *in futuro* is worth less than $83.1 million in hand. The New Haven assets were valued at net liquidation value and the consideration should have been valued at net liquidation value. The formula deprives New Haven of interest on at least $23 million, possibly until February 1, 1978. It imposes the selling expenses of the 950,000 shares upon the New Haven. It fails to provide any security, yet requires the transfer of the New Haven assets free and clear of liens and encumbrances.

The formula does not cure the defects arising from the Commission's failure to provide the equivalent of the assets transferred.

C. Although from the time the New Haven filed its petition for reorganization in 1961 the Reorganization Court and the Commission were aware the New Haven collapse was complete and no reorganization under which railroad operation could be continued by the New Haven was possible because its deficits were system-wide and even the elimination of all fixed charges would not eliminate the deficits, the Commission and the Reorganization Court nevertheless required the continuation of operations, considering that the public interest in rail transportation in New England permitted the erosion of approximately $70 million of the bondholders' security. The public interest was overprotected and the erosion exceeded constitutional boundaries. Even if some erosion of the bondholders' security is permitted, a proposition rejected by precedent, the erosion was unreasonable. Because the Commission intended the New Haven to become an integrated part of a larger system, it required the continuation of all New Haven railroad service at staggering losses until the Penn Central merger was complete so that the public would have uninterrupted service at the expense of the bondholders' security and Penn Central would be spared the expense of starting up a railroad which had ceased to operate. Penn Central, having agreed to assume the New Haven operations to assure Commission approval of its merger, should bear the erosion and pay the value of the intangible assets. Even if the Commission had the power to divide the burdens of deficit operations between the New Haven and Penn Central, a proposition rejected

by precedent, the Commission did not fairly divide the burdens. Penn Central was not required by the Commission to bear any of the burdens of deficit operations until after the date of its merger. The Commission's division of the burdens after the merger imposed the bulk of the post-merger deficits on the New Haven even though the Commission earlier assumed its formula for the division of the burdens would impose all the post-merger losses on Penn Central. The Commission refused unfairly to adjust the formula when its earlier estimates proved substantially incorrect.

III

The New Haven was an equal partner in certain real estate in New York City having an undisputed market value of $227,500,000. The Commission and the courts have approved a price of $28.4 million for the conveyance by the New Haven of all its interest in the property to Penn Central. This price is grossly unfair. It is predicated upon the false assumptions that the New Haven would lose its right to $5.6 million of annual income if it ceased to operate passenger service into Grand Central Station and that there were no prospective purchasers of the New Haven's interest who would be willing to operate the service. The New Haven was entitled to be paid for every benefit it transferred. Penn Central, however unwillingly, had volunteered to assume the New Haven operations to satisfy the Commission-imposed condition to its merger. It was a prospective purchaser. In addition to Penn Central, the States of Connecticut and New York were prospective purchasers. The consequence of attributing no value to the New Haven's right to $5.6 million of annual income from the G.C.T. properties which the New Haven had used to

defray all of its share of terminal expenses, is to effect a forfeiture for the benefit of Penn Central of at least $70 million. The payment of $28.4 million frees Penn Central to sell $227,500,000 of real estate, none of which could be sold without New Haven's consent prior to the December 31, 1968 transfer to Penn Central. The courts improperly failed to award interest on "excess income" debts to New Haven due by contract.

IV

Although the Reorganization Court remanded to the Commission the recomputation of discounts to present value in accordance with generally accepted accounting principles, the Commission made errors of a substantial nature, some to the detriment of New Haven and some to the detriment of Penn Central. Although the parties introduced evidence as to the method of computation and the testimony of their witnesses was in substantial agreement in most areas, the Commission rejected the testimony and persisted in its miscalculations. The Reorganization Court recognized corrections which required an increase in the price of approximately $3.6 million and corrections requiring a diminution of the purchase price of approximately $1.4 million and it accepted minor corrections computed by the Commission in the amount of $130,000, for a net correction which required an increase to the purchase price of approximately $2.4 million. The Reorganization Court had the power to correct gross errors of a mathematical nature without further remand.

V

The Commission, in considering the value of 160 acres of New Haven real estate in the south Bronx, New York City known as the Harlem River and Oak Point Yards, mis-

understood the testimony presented. It based its selection of appraised values upon the assumption that industrial users would have no access to rail service under the assumptions of a hypothetical liquidation of the New Haven. The New Haven would not elect, in liquidation, to tear up the tracks which permit rail service via a connection with Penn Central at the boundary of the acreage if such destruction would diminish substantially the value of its real estate. It was absurd to value the property as if Penn Central could refuse rail service where New York City and New York State require the service and exercise substantial power over Penn Central. The Interstate Commerce Act requires Penn Central to offer reasonable service.

VI

The New Haven held shares for investment in certain substantial enterprises. The Commission attributed no value to these shares. It could not, therefore, require the transfer of these shares to Penn Central. The absence of offers for shares is not evidence of an absence of value. The book value of the shares was substantial. The transfer required by the Commission without consideration was unconstitutional.

ARGUMENT

I

Since the Commission deprived the New Haven of due process of law by subordinating its responsibility to find the value of the New Haven assets and the equivalent consideration as impartial judges to its administrative function of formulating national transportation policy, this Court should provide, or require the courts below to provide, the uninhibited judicial review called for by the extreme circumstances of this case.*

The New Haven filed its petition for relief under Section 77 of the Bankruptcy Act in July, 1961. Even while granting the petition the Reorganization Court recognized that the New Haven case was unique because reorganization was not feasible since the anticipated revenues could not be expected to equal the anticipated expenses even if all of the fixed charges for bonded indebtedness were eliminated.

In its Memorandum Decision of July 26, 1961 appointing the New Haven Trustees, the Reorganization Court stated:

> "Unlike most reorganizations under Sec. 77 of the Bankruptcy Act, *this case does not have as its sole or chief purpose the modification of the debt structure,* but the actual survival of the New Haven Railroad as

* In the argument addressed to the valuation of the consideration to be paid by Penn Central and specific elements of the New Haven assets, it will be shown that the Commission's methods and findings of value are arbitrary and capricious and not supported by substantial evidence. The argument here is designed to show that the substantial evidence rule is inapplicable to this case because the Commission did not impartially exercise its judicial function.

a system of transportation for passengers and freight. * * * If, in this case, some pattern for survival can be worked out, it will contribute materially to the solution of other cases—and this is so in spite of the fact that *there is much about the New Haven Railroad and its problems which is unique and distinguishes it from others. This contribution will be largely in the field of the relationship between the Federal and State governments and an essential, but collapsed, privately-owned public utility,* as well as in the field of new interpretations and applications of Sec. 77 of the Bankruptcy Act, and in the realm of new legislation which may be needed. * * *

It has been clear for some time that the cure for the New Haven's difficulties cannot be found in the typical reorganization procedure. It is likely that new and untried arrangements for continuing the movement of passengers and freight by rail in New England will have to be adopted." (Cert. R. Doc. #1) (emphasis added)

The Reorganization Court, the Trustees and the Commission, coerced by the unfortunate impact on the public if the New Haven railroad operations ceased,* determined to continue operations, at substantial losses, in order to keep the operating structures intact until a buyer could be found who would continue to provide the service, rather than to terminate the inevitable losses and permit foreclosure and sales to buyers who would dismantle the property. In 1962, Penn and Central, the first and fourth largest railroads in the country, sought to merge. The

* In the *Penn Central Merger Case,* former Commissioner Tucker stated: "The New Haven Railroad is the fourth largest private carrier of passengers in the world. Its freight revenues alone exceed the total revenues of either of the B&M, D&H, Jersey Central, Susquehanna, or Western Maryland railroads." 327 I.C.C. at 551.

Department of Justice (Antitrust Division) unconditionally opposed the merger. Penn and Central thereupon agreed to purchase the New Haven's assets and to continue the railroad service and thereafter the Justice Department withdrew its unconditional opposition to the merger.* The Commission in approving the Penn Central merger relied heavily upon the benefit to the public which would follow from a merged Penn Central's continued operation of the New Haven service as well as on the public interest in the financial strengthening of Penn and Central through merger savings.**

When the "contribution * * * between the Federal and State governments and an essential, but collapsed, privately owned utility" did not materialize, the Commission was confronted with a dilemma; its statutory powers were inadequate to permit it lawfully to satisfy the public interest in continued New Haven operations. *St. Joe Paper Co.* v. *Atlantic Coast Line R.R. Co.*, 347 U. S. 298 (1954).†

If the Commission had had before it simply the determination of the value of the New Haven assets, it could dis-

* As this Court has noted, Penn and Central had earlier refused to purchase the New Haven. See *Penn-Central Merger and N&W Inclusion Cases, supra,* at 494 (1968); *Baltimore & Ohio R. Co.* v. *United States,* 386 U. S. 372 (1967).

** Penn Central's calculation that agreeing to take over New Haven operations would shift the balance in favor of approval of its merger proved accurate. See 327 I.C.C. at 475.

† On the facts recognized by the Reorganization Court, the petition for reorganization would not have been granted initially but for the imperative public interest. The Reorganization Court clearly anticipated new legislation would be forthcoming to provide assistance to eliminate the erosion of the creditors' security pending development of a scheme which would preserve railroad transportation in New England. See pp. 35-36, *supra.*

interestedly have found that value. But precisely to the extent that impartial determinations on the basis of the evidence demanded that the Commission require Penn Central to pay a price higher than that volunteered by Penn Central when the Justice Department still opposed the merger, the Commission saw itself as the instrument through which the "public" would be deprived of some of the benefits of the Penn Central merger. It concluded that its responsibility for the design of national transportation policy required it to fix a low price to aid the merged system.

The dilemma of the Commission may be simply stated. On the one hand the Commission was required to find the fair and equitable value of the New Haven assets subject to the approval of the Reorganization Court, which implied liquidation value as the minimum permitted by the Constitution; on the other, the Commission considered itself obliged to preserve the merger benefits anticipated to accrue to Penn Central. But the imposition on Penn Central of the obligations to continue the deficit-producing New Haven operations necessarily impaired, to some extent, the merger benefits.

The Commission elected to preserve the merger savings, abandoned its judicial impartiality and tailored its findings and conclusions to suit the accomplishment of its administrative functions. The normal respect due the findings of an administrative agency should not be accorded to the Commission's reports.

This case presents dramatically the "conflict of interest" problem inherent in an adjudication by an administra-

tive agency charged with the making of policy.* Fundamentally, this case simply involves the price to be paid on the sale of the property of a large company to a giant company. Cases involving the fairness of such transactions are commonly presented to the courts without intervention of an administrative agency. Some common examples are condemnation cases, sales by fiduciaries and cases in which dissenting shareholders to a corporate merger seek the adjudication of the value of their shares. In those cases the judicial function is limited ordinarily to a determination of the fair market value of the property being transferred without regard to the commercial value of the property to the specific purchaser. The determinations of value in this case, however, have been overwhelmed by the Commission's interest in the public benefits to be derived from the merger of Penn Central, the largest railroad merger in history, and the Commission's recognition of the hopelessness of achieving a reorganized New Haven capable of providing

* Commissioner Elman of the Federal Trade Commission has described the problem as follows: "[T]he stresses and strains on administrative adjudication are especially acute when the result in a particular case may have a bearing upon a general policy or program to which the agency is committed. Unlike judges, who sit as neutral and detached adjudicators, agency members who are responsible for deciding the particular case are also responsible for advancing the goals and effectuating the policies of the statutes which the agency administers. Its success or failure is measured by the general results, or lack of them, which the agency achieves in carrying out its statutory mission. Unlike a judge, an agency member cannot overlook the effect which a decision in a particular proceeding may have on related proceedings before the agency. The fusion of functions within the administrative process affords great benefits in flexibility of action; but it also gives rise to dangers which agency members must acknowledge, and resist as best they can." *House of Lord's Inc.*, 3 Trade Reg. Rep. par. 17,437 at 22,674 (FTC 1966). See also, Jaffe, *Judicial Control of Administrative Action*, 20-27 (1965); Elman, *A Note On Administrative Adjudication*, 74 Yale L.J. 652 (1965).

railroad service to New England absent the Commission's assumption of a power to compel Penn Central to purchase the assets and provide the service.

Whereas the Commission at first appeared to have found a public interest justification for the Penn Central merger in Penn Central's willingness to assume the New Haven operations as a merger condition,* it later confessed that Penn Central's merger application could not have been properly denied even without its acceptance of this condition because the merger savings strengthened the stability of both roads and redounded to the benefit of the using public. (334 I.C.C. at 66; p. 153a.) Thus it can be seen that even in the imposition of condition 8 (that Penn Central acquire the assets of the New Haven and operate the deficit-producing service) the Commission recognized that already in the Penn Central merger case it had subordinated its judicial function to its administrative assumption of power; in the fixing of the price Penn Central should pay for the New Haven assets it considered itself bound to lean over backwards to ameliorate the impact of condition 8. The Commission accepted this improper position because neither the states nor the Federal government had acted to condemn or subsidize the New Haven operations in the public interest. The Commission sought to provide that legislation by imposing a portion of the subsidy temporarily upon Penn Central** and a portion of the subsidy in perpetuity upon the New Haven bondholders. From its first

* See *Penn Central Merger Case, supra* at 524.

** The Commission reserved the power to relieve Penn Central of the deficits if the states do not in the future assist Penn Central. *Penn Central Merger Case, supra,* at 525-6. The states have already prepared to take over substantial segments of the Penn Central's New Haven Division deficit passenger operations.

approval of the Penn Central merger, the Commission was constrained to preserve to Penn Central the benefits of the merger.

The Commission has repeatedly made clear that it understood its dominant function to be to assure the continuation of the New Haven's railroad operations by the transfer of those operations to a profitable and successful Penn Central.*

In the Inclusion Report, the Commission stated:

> "* * * as the agency entrusted with and responsible for 'developing, coordinating, and preserving a national transportation system by water, highway, and rail, as well as other means, adequate to meet the needs of the commerce of the United States, of the Postal Service, and of the national defense,' *our efforts necessarily must be directed towards assuring the continuation of the NH's railroad service.*" (331 I.C.C. at 700; p. 58a) (emphasis added)

The Commission's "efforts" were also directed toward the preservation of the Penn Central merger benefits. To achieve its two goals the Commission contends that "fairness to the public" overrides any requirement that it find the fair market value of the New Haven assets and require payment of an amount equal to that value. It does not even consider that it is bound to be "fair" to the New Haven creditors or to fix a price "constitutionally re-

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* "*Our prime purpose* in requiring inclusion of NH in the merged Penn-Central system *is to assure continuity of NH service* (which we have found essential to the public) *as an integrated part of the Penn-Central system* and under the system's management." (331 I.C.C. at 653; p. 11a) (emphasis added)

quired". In the Remand Report the Commission acknowledged the dilemma and proposed a resolution:

> "The creditors point to the potential savings resulting from the [Penn-Central] merger as the major justification for whatever price is *fair* to them *or constitutionally required.* We did not approve the merger in order merely to satisfy the creditors of NH or even primarily to rescue NH. * * * We spoke * * *, in terms of fairness to the public, and to the security-holders of both NH and Penn-Central. * * * While the provision of a home for the NH was an important consideration, particularly regarding the timing of the merger, it was not alone decisive of the merits of the merger. There were many other public interest factors supportive of the merger; * * * *A significant tapping of the annual savings to favor the NH creditors would not be in public interest.* The savings are needed to support the transportation operations of the former Penn and Central, now the country's largest transportation system". (334 I.C.C. at 66; p. 153a) (emphasis added)

The foregoing must be read in the light of the opinion of former Commission Chairman Tucker in the *Penn Central Merger Case*:

> "Furthermore, in a balancing of the benefits and detriments of the present transaction, the *New Haven Railroad problem must be given very substantial weight.* The newly merged railroad corporation enabled herein will provide a framework for preservation of an important rail plant—serving four States in a highly populous area—*which, but for this unification, might face liquidation.*" (327 I.C.C. 475, at 550-551) (emphasis added)

The Commission has confessed more than its bias in favor of a low price to Penn Central. It has confessed it abdicated its responsibility to fairly hear the evidence presented to it and to adjudicate the issues impartially and justly. The Commission stated:

> "A paramount consideration in these proceedings is the continuation of NH's essential service. As previously stated, the record demonstrates that such service is in jeopardy because of the serious attrition of NH's cash resources. *The findings and conclusions made herein and the action resulting therefrom are designed to meet this problem.*" (331 I.C.C. at 655; p. 13a) (emphasis added)

The litigants, after more than 40 days of contested hearings and the submission of a massive quantity of exhibits, are entitled to expect findings and conclusions based upon the evidence presented and not "designed to meet this problem."*

Whereas in the Inclusion Report the Commission's inhibitions arising from its imposition of the New Haven's operations on the surviving transportation system could be uncovered only by an analysis of its treatment of the evidence, in the Remand Report the Commission has come out in the open by adjusting the price to ease the impact of this imposition. The Commission stated:

> "To ignore Penn Central's interest under the statutes or the Constitution would be to ignore the public interest in preserving NH service; if the price required in

* With respect to the findings of valuation of both the assets and the consideration it must be noted that *no* commissioner heard the evidence and the Hearing Examiner to whom the evidence was presented filed *no* report.

law for NH is so high that we would be compelled to hold it unfair to Penn Central the result would be to deny the public need for the service. Whether we view the interests of the estate or the rights of the creditors, we are of the view that the Constitution requires but a fair price, and that such a price cannot in logic or law be divorced from what is fair to Penn Central." (334 I.C.C. at 75-6; pp. 162a-163a).*

The only alleged "unfairness" to Penn Central of requiring payment of at least the full salvage value of the New Haven rests upon the assumption that Penn Central cannot liquidate the New Haven's assets because the Commission has imposed upon it the burden of continuing the railroad service (334 I.C.C. at 66; p. 153a). The Commission cannot, by the device of fixing a price less than the market value of the assets, tax the New Haven creditors with a share of the burden of Penn Central's anticipated losses from future operations and stamp upon the price tag the words "fair and equitable". The burden has been imposed upon Penn Central by the Commission and not by the New Haven and if the burden becomes too great, the Commission can relieve Penn Central of all or a portion of it (334 I.C.C. at 67; p. 154a).

Understandably, the Commission is concerned with the "public" whose interest it is charged to cherish. But the proposed transaction is a sale of New Haven assets to Penn Central upon "fair and equitable terms", and the New Haven must be paid the fair market price for its assets as shown by the evidence, and not a price which most benefits the public. The payment of the proper price is not

* See pages 57-67, *infra*.

inconsistent with the public interest because it invades, to some modest extent, the enormous financial benefits anticipated from the Penn Central merger (331 I.C.C. at 688; p. 46a).

Since the Commission had and has the power to relieve Penn Central of the deficits, it was never right for it to fix a price colored by those deficits. Nor is the situation affected because the assets have already been transferred to Penn Central free and clear of liens. No heroic measure such as "unscrambling" is necessary. Penn Central need only be relieved of the burden of maintaining the service and be permitted to liquidate the New Haven, realizing the salvage value. It is not the payment of full salvage value that is unfair to Penn Central. It is the imposition of overburdensome deficits that may work unfairness. To hold that the Commission may require the New Haven bondholders to accept less than full salvage value is to hold that the mortgagees must be required to take less than the value of their security because of the Commission's power over Penn Central. The Commission's dilemma may not be resolved by constrained and tortured evaluations of evidence which have the effect of concealing the denial of due process behind a veil labeled "valuation findings."*

* The Reorganization Court has declared: "The Commission also asserts that, because the Constitution does not specify any particular method of valuation, it possesses unrestricted flexibility and range of discretion; and 'due process' and 'just compensation' referred to in the Fifth Amendment mean compensation based upon the value of the assets remaining after the debtor's estate has been invaded to the unlimited extent the Commission finds is called for by the paramount public interest, provided the Commission takes pains to declare it fair and equitable. This is tantamount to no constitutional protection whatever." (304 F.Supp. at 799; p. 282a)

The Commission's prejudice in favor of the surviving transportation system has dominated its findings and conclusions throughout these proceedings. The Bondholders Committee does not contend that the mere combination of functions in the Commission automatically vitiates its decision. But where the Commission's own reports make it crystal clear that policy factors have so dominated the Commission that an impartial adjudication of the evidence by it is seriously inhibited, due process is denied and the reviewing courts should, at the very least, subject the proceedings to close scrutiny and a thorough judicial review uninhibited by the technicalities of the substantial evidence rule. See *In re Larsen,* 17 N.J. Super. 564, 86 A.2d 430 (App. Div. 1952) (concurring opinion, Brennan, J.); Jaffe, *Administrative Law: Burden of Proof and Scope of Review,* 79 Harv. L. Rev. 914, 919-920 (1966).

In *Atlantic Coast Line R.R.* v. *St. Joe Paper Co.,* 179 F. 2d 538 (5th Cir. 1950), *cert. denied,* 339 U.S. 929 (1950), the creditors objected to the reorganization plan approved by the Commission and accused the Commission of having sacrificed the interests of the bondholders to the Commission's finding that the public interest required the Florida East Coast Railway be controlled by Atlantic Coast Line and not by the St. Joe Paper Company. In defining the duty of a reorganization court in approving or disapproving a plan certified to it by the Commission as fair and equitable the Circuit Court held:

> "*This duty was,* in according due weight to the determination of the Commission on that issue, that the plan was fair and equitable to the bondholders, *to subject the proceedings to the closest scrutiny, to find out*

whether this determination was lawfully and constitutionally arrived at, that is, whether it was arrived at with a clear vision of, and an eye single to, that issue or, as appellees claim is the case, it was arrived at with a vision foreshortened by a too intense regard of, and preoccupation with, the question of which should control the debtor, St. Joe or the Coast Line.

"He should do this, not to differ from, or take issue with, the view that the majority, rather than the minority, of the commission has rightly decided the public interest matter. He should do it to ascertain whether the majority of the commission has subordinated its determination, that the plan is fair and equitable, to, or weighted that determination with, considerations of its bearing and effect upon its finding that the property must be merged with Coast Line. *He should particularly seek to ascertain whether, as a result of this subordination and weighting, the determination of what is fair and equitable to the bondholders has been reached at a sacrifice of the private interests in order to give effect to the supposed dominant public interest that Coast Line should have the properties.*

"*If, upon such scrutiny of the record, it appeared to the trial judge: that there was such preoccupation* by the majority with its supposed dilemma, Coast Line or St. Joe, or *with any other interest or concern except the one of dealing justly and fairly with the bondholders of the debtors;* that it has prevented or occluded the clear view of them the law requires the commission to have and take; and that, as a result, the constitutional and legal rights of the bondholders have been unfairly cut down to fit them into the Coast Line public interest pattern the commission majority has determined upon; *he was not only authorized but required to disregard the commission's findings,* that the plan was fair and equitable, in favor of his own, that the plan was not" (179 F. 2d at 542-3) (emphasis added).

Where, as here, it is apparent that the Commission, because of its multiple functions, was incapable of the neutral and critically detached analysis of the evidence to which litigants are fairly entitled, the courts should restore the balance of fairness. But in this case, neither the Statutory District Court nor the Reorganization Court attempted to enlarge the scope of its inquiry to compensate for the unfairness of the proceedings.* It is left to this Court to provide or require the uninhibited judicial review called for by the extreme circumstances of this case.

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* When the actions seeking review of the Inclusion Report were first instituted before the Statutory District Court, the United States moved to dismiss the complaints on the grounds that the Reorganization Court had exclusive jurisdiction to review the Commission's determinations. The motion caused the Statutory District Court to set forth its view of the standard of review applicable to each of the Courts, as follows: "There is, indeed, an area of overlap between the work of the two courts. We must determine, among other things, whether there is substantial evidence to support the figure fixed by the I.C.C. as the price to be paid by Penn-Central for the assets of the New Haven, and the Reorganization Court must decide whether the plan, importantly including the price, is fair and equitable. Since *the scope of the Reorganization Court's inquiry may well be broader than that of a court of three judges reviewing a §5 order,* we can conceive of circumstances where it would be appropriate for the latter, not indeed to dismiss as the United States urges, but rather to stay its own proceedings pending decision by the bankruptcy court * * *. It may also be doubtful whether Penn-Central would be bound to accept modification proposed by the bankruptcy court to the same degree as in a direct review of the Commission's order, *although the bankruptcy court, of course, is free, subject to normal review, to refuse inclusion of the New Haven save on terms it deems appropriate.*" (289 F. Supp. at 424-25 fn. 3) (emphasis added)

II

The Commission's deduction from net liquidation value of $22.1 million, its failure to require full payment in the equivalent of cash for the New Haven assets and its failure to provide compensation for the erosion of the bondholders' security, violate the Fifth Amendment of the Constitution and are not fair and equitable.

In its method of valuing the assets transferred by the New Haven and the consideration to be paid by Penn Central for those assets and in failing to provide compensation for the erosion of the security of the bondholders imposed by the Commission and the Reorganization Court until the transfer of the New Haven assets, the Commission has violated the constitutional rights of the bondholders. Since the Commission and both courts appear to hold that the price to be paid by Penn Central ought in the public interest to be the minimum price required by the Constitution, a definition of the constitutional rights of railroad bondholders is required.

Upon its review of the Inclusion Report, the Statutory District Court clearly held that the net liquidation value* of the New Haven assets represented the minimum price permitted by the Constitution. The Statutory District Court concluded:

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* Both the Statutory District Court (p. 411a) and the Reorganization Court (304 F.Supp. at 793; p. 280a) make clear that the term "liquidation value" means "fair market value". The Commission referred to the evidence as "showing asset values upon an assumed liquidation" (331 I.C.C. at 657; p. 15a) and equated "liquidation value" with "the values that sales of the railroad in parcels for their highest and best use would bring" (334 I.C.C. at 53; p. 140a).

> "But when the asking price for the acquired road is what the Constitution demands the owners must receive as a condition to allowing the road to be operated in the public service, we think—subject only to what we shall say hereafter as to interim losses—that the Commission may not fix, or approve, anything less" (289 F.Supp. at 441; pp. 360a-361a).*

Despite the holdings of the courts, the Commission has on remand rejected the principle that net liquidation value represented the minimum price permitted by the Constitution. In the Remand Report, the Commission concluded that "the net liquidation value of the NH estate is $162.7 million" (334 I.C.C. at 53; p. 140a).** It then stated:

> "It appears, therefore, that an inflexible rule of law prescribing liquidation value (as computed above) as the minimum to which the creditors are entitled might lead to unfair results. In regard to this we believe there are other considerations relevant to the price the creditors should expect to receive and Penn Central to pay. We proceed further in this analysis, because we believe that the liquidation value we have found

* The Statutory District Court was, of course, discussing the impact of the Constitution upon §5(2))(d) of the Interstate Commerce Act. Since in this case, neither the Trustees, the Reorganization Court nor the New Haven bondholders have assented to or approved the terms set by the Commission, there has been no voluntary assent on the part of the New Haven. Section 5(2)(d), the application of which is dependent upon the voluntary acceptance of terms by the seller, is now basically inapplicable to this case insofar as the New Haven is concerned. See *Penn-Central Merger and N&W. Inclusion Cases, supra,* at 517-18, 526. The physical assets of the New Haven were, by Commission order approved by the Reorganization Court, transferred to Penn Central without prejudice to the right of any party to contest the terms of the sale (334 I.C.C. at 76; p. 163a; Order dated December 24, 1968, p. 269a).

** While the Commission did not add the phrase "as of December 31, 1966", that date must follow from a reading of both Commission reports. See 331 I.C.C. at 688; p. 46a; 334 I.C.C. at 30; p. 117a.

above is not itself a fair and equitable price and is not required as a matter of law" (334 I.C.C. at 54; p. 141a).

The Commission then defined the "other considerations relevant to price" as the public's interest in having the railroad service continued by Penn Central. It stated:

> "It is inequitable to conceive at the same time both a right in the bondholders to break up the NH and an obligation on Penn Central to keep it going. The demands of equity are no more satisfied by conceiving that the bondholders have a constitutional right to shut down the NH which is superior to the public's right to keep it going" (334 I.C.C. at 54; p. 141a).

But the bondholders' constitutional rights to shut down the New Haven *are* superior to the "public's right to keep it going." The public's "right" is not a constitutional right at all, but is in fact limited by the Fifth Amendment to the Constitution. The Commission's approach depends upon its incorrect interpretation of the Constitution and the cases of *Brooks-Scanlon Co.* v. *Railroad Commission,* 251 U.S. 396 (1920); *Bullock* v. *Railroad Commission,* 254 U.S. 513 (1921); and *Railroad Commission* v. *Eastern Texas Railroad,* 264 U.S. 79 (1924). The Commission states:

> "The Supreme Court in our view has never flatly held that a deficit-ridden railroad has an absolute right to abandon, liquidate, and sell the parcels. The thrust of *Eastern Texas, Brooks-Scanlon,* and *Bullock* is that a deficit railroad has a right to stop the deficits. It does not follow, we believe, that it has the immediate right to abandon, nor the rights derived therefrom to break up the railroad and to receive the maximum salvage value" (334 I.C.C. at 56; p. 143a).*

* In this regard, the Statutory District Court stated "we would suppose that the constitutional right to abandon operations implies a right to break up the railroad and sell the parcels for their highest and best prices" (p. 417a).

The Commission does not dispute the fact that the New Haven was a "deficit-ridden" railroad and no one can justly quarrel with the statement of the Reorganization Court that "New Haven's deficits were not limited to unprofitable segments of an overall profitable system. Quite the contrary. New Haven's long-time deficits were system wide" (304 F.Supp. at 793; p. 287a). In the Inclusion Report the Commission stated: "If there is one thing on this record that is clear and undeniable, it is that NH has neither earning power nor the prospect of earning power" (331 I.C.C. at 687; p. 45a). Under these circumstances, the "public's right" to continued railroad service at the expense of private interests, which can only be derived from Section 1(18) of the Interstate Commerce Act or Section 77 of the Bankruptcy Act, does not exist.

In *Brooks-Scanlon Co.* v. *Railroad Commission*, 251 U. S. 306 (1920), the carrier simply shut down its losing railroad operation. The Louisiana Railroad Commission sought an order requiring railroad operation on the grounds of the public interest and on the ground that the carrier had failed to comply with the state law requiring a railroad to petition the Louisiana Railroad Commission for leave to discontinue. The unanimous Court (opinion by Justice O. W. Holmes), held:

> "If the plaintiff be taken to have granted to the public an interest in the use of the railroad it may withdraw its grant by discontinuing the use when that use can be kept up only at a loss" (251 U.S. at 399).
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> • • •
>
> "Whatever may be the forms required by local law [a petition for leave to discontinue] it cannot give the

> Court or Commission power to do what the Constitution of the United States forbids, which is what the order and injunction attempt'' (251 U. S. at 490).

In the case of *Railroad Commission of Texas v. Eastern Texas Railroad,* 264 U. S. 79 (1924), the State of Texas attempted to enjoin the abandonment and dismantling of a deficit railroad. The unanimous Court, citing the *Brooks-Scanlon Case,* held:

> ''The usual permissive charter of a railroad company does not give rise to any obligation on the part of the company to operate its road at a loss. No contract that it will do so can be elicited from the acceptance of the charter or from putting the road in operation. The company, although devoting its property to the use of the public, does not do so irrevocably or absolutely, but on condition that the public shall supply sufficient traffic on a reasonable rate basis to yield a fair return. *And if at any time it develops with reasonable certainty that future operation must be at a loss, the company may discontinue operations and get what it can out of the property by dismantling the road. To compel it to go on at a loss or to give up the salvage value would be to take its property without the just compensation which is a part of due process of law''* (264 U.S. at 85) (emphasis added).

The Commission's view that the rationale of the *Brooks-Scanlon Case* was overruled *sub silentio* by this Court in *Colorado* v. *United States,* 271 U.S. 153 (1926) (334 I.C.C. at 56; p 143a), would seem to be thoroughly repudiated by the citation of the *Brooks-Scanlon* and *Eastern Texas Railroad* cases as authority in the 1936 case of *Pacific Telephone & Telegraph Co.* v. *Tax Commission,* 297 U. S. 403, 413 (1936).

The Commission itself has recently relied upon the rationale of the *Brooks-Scanlon Case* in a case involving a railroad in reorganization under Section 77. In *Tennessee Central Railway Co., Abandonment,* 333 I.C.C. 443 (1968), the Commission stated:

> "It is well established that a carrier should not be required to continue in the business of carriage when its overall operations are conducted at a systemwide deficit for a substantial period of time and where there is no reasonable prospect of the applicant's conducting those operations at a profit for the foreseeable future." (333 I.C.C. at p. 452)

The *Brooks-Scanlon and Eastern Texas Railroad* cases make it clear that while in a free enterprise economy the investor assumes the risk that the business in which he invests may not be successful, he does not assume the obligation to continue the business because there is a public interest in its operation.

The Commission framed the issue as a conflict between the constitutional "right of the bondholders to break up the NH" and the Commission imposed "obligation on Penn Central to keep it going". (334 I.C.C. at 54; p. 141a). Even assuming that the combination of Section 77 of the Bankruptcy Act and Sections 1(18) and 1(20) of the Interstate Commerce Act permit the Commission to require the New Haven to favor among prospective purchasers that customer who would continue the operations, those statutes do not give the Commission power to designate a price lower

than the price the New Haven would otherwise receive in liquidation sales made at fair market value.* A hopeless, deficit-ridden railroad must be permitted to stop operation and recover at least its salvage value unless the Commission provides, or a third party offers to pay, the equivalent. The Commission itself designated Penn Central as the customer. Since Penn Central, by its merger, has accepted the obligation to fulfill the public interest requirements, *it* must pay the equivalent.

The Commission has made clear that it intends to cast upon the New Haven estate a share in perpetuity of future operating losses. It states:

> "*In valuing the estate, we cannot ignore* the fairness to Penn Central. We do not read either section 5 or section 77 to require the fairness to the estate to be determined without regard to *the public interest or to the fairness to the buyer.* * * *
>
> The NH liquidation value is in many respects highly hypothetical insofar as Penn Central is concerned; it is a value that for the most part is unrealizable by Penn Central and frozen into the assets. *Penn Central is not free to liquidate and must continue the operation of the property in the public interest.*" (334 I.C.C. at 65-66; pp. 152a-153a) (emphasis added)

But the New Haven's property cannot be sacrificed to the public interest because the Commission designated

* Prior to this case, the Commission has, so far as we are aware, consistently recognized that any power it might have to require sale of a railroad to a purchaser who will continue operations required payment of at least "salvage value" to the seller. See *New York Central R.R. Acquisition of Chicago, Attica & Southern R.R.*, 187 I.C.C. 527 (1932); *New York Central R.R. Co. Acquisition of Boyne City, R.R.*, 180 I.C.C. 538, 564-5 (1932); *Jay Street Connecting R.R. Abandonment*, 307 I.C.C. 137, 163 (1959); *Tennessee Central Ry. Co. Abandonment*, 333 I.C.C. 433, 454-5 (1968).

Penn Central to be the buyer and has required it to continue operations. If the burden becomes too great, the Commission can relieve Penn Central of all or a portion of it (334 I.C.C. at 67; p. 154a)* and even permit Penn Central to liquidate the New Haven properties and realize the full salvage value.

In the leading case of *Louisville Joint Stock Land Bank* v. *Radford,* 295 U.S. 555 (1935), the issue presented to the Court was whether the public interest in protecting the nation's farm economy enabled Congress to enact bankruptcy legislation (Frazier-Lemke Act of 1934) which restrained foreclosure and took away the mortgagee's security upon payment of an amount less than the face value of the debt, but equal to the appraised value of the property. Justice Brandeis, speaking for a unanimous court, held the statute to be unconstitutional.

The Commission here has presented a program even more fatally infirm than the *Radford Case* presented. The Commission, under the umbrella of the public interest in railroad service, has interpreted Section 77 of the Bankruptcy Act to permit a sale of the bondholders' security upon payment of an amount less than the face value of the debt and *less than the appraised market value of the property.* The *Radford Case* makes it plain that such an interpretation must be held unconstitutional. In that case, Justice Brandeis concluded:

> "For the Fifth Amendment commands that, however great the Nation's need, private property shall not be

* The losses may be eliminated or reduced by efficiencies, train discontinuances, line abandonments, and government assistance. The tax on the New Haven estate will not be relieved.

> thus taken even for a wholly public use without just compensation. If the public interest requires, and permits, the taking of property of individual mortgagees in order to relieve the necessities of individual mortgagors, resort must be had to proceedings by eminent domain; so that, through taxation, the burden of the relief afforded in the public interest may be borne by the public." (295 U.S. at 602)

The law can be no different because the Commission, to satisfy the public interest, has found a non-governmental buyer that has obliged itself to operate the railroad in order to reap the substantial benefits resulting from the Commission's conditional consent to merge.

The Fifth Amendment does not make an exception for situations where the public need is great and the States and Federal Government have not provided funds to make just compensation. See Black, *The Bill of Rights*, 35 N.Y.U.L. Rev. 865, 877-8 (1960).

* * *

A. The "pricing considerations" of abandonment delay and bulk sale discount, introduced by the Commission in the Remand Report, were arbitrary deductions of $22.1 million from the New Haven's minimum constitutional liquidation value.

In the Remand Report, the Commission summarized its findings as follows:

> "Under the instructions of the three-judge court, *we have found the liquidation value of NH is $162.7 million. We have further found that other pricing considerations require and justify a reduction of $22.1 million from the liquidation value.* We find and con-

> clude that a price that is equitable to the estate and to Penn Central results from the $22.1 million reduction, and that NH is, therefore, entitled to consideration totalling $140.6 million." (334 I.C.C. at 65; p. 152a). (emphasis added.)

The $22.1 million deduction consists of $15,386,000 for so-called "abandonment delay" (334 I.C.C. at 58-59; pp. 145a-146a) and $6,695,000 for so called "bulk sale discount" (334 I.C.C. at 60-63; p. 147a-150a).

The Commission's "explains" why these discounts were not discussed in the Inclusion Report as follows:

> "In the *inclusion* report, we found that the consideration Penn Central had agreed to pay would equal liquidation value there shown, and that made it unnecessary for us to explore other pricing considerations. The liquidation value that results in this reopened proceeding exceeds the agreed price, obliging us to make a new determination as to whether the price resulting from such valuation is fair." (334 I.C.C. at 54; p. 141a). (emphasis in original)

Since the "exploration" of "other pricing considerations" was directed only toward reductions from liquidation value, it is evident that the Commission's "fairness" inquiry was solely as to whether it believed that it was "fair" *to Penn Central* for it to pay a price greater than it had earlier agreed to pay.* In fact, there was no inquiry;

* The Commission delineated no standards of "fairness". Had it undertaken an analysis, it would have recognized that if it had not deducted the $22 million from the liquidation value, the increased burden to Penn Central would have been $1.265 million of the projected $81 million of annual merger savings (327 I.C.C. at 501; 389 U.S. at 493). (The figure of $1.265 is arrived at on the basis of payment by delivery of $25.3 million face value of Penn Central 5% bonds.) On the 23 million shares of Penn Central outstanding, Penn

the two discounts were arbitrary and capricious and were manufactured by the Commission to minimize any increase in the consideration Penn Central had agreed to pay in its 1964 negotiations with the Trustees.*

The history of these proceedings point inexorably to the conclusion that before it had heard a single witness, the Commission had determined to find the consideration Penn Central had agreed with the Trustees to pay for the New Haven assets was fair and equitable to both sides and in the public interest. Indeed, when the Commission wrote condition 8 which provided that Penn Central was required to purchase the New Haven assets and provide its service "upon such fair and equitable terms as the parties may agree subject to the approval of the Bankruptcy Court and the Commission" (327 I.C.C. at 553), the Commission already knew the terms to which Penn Central had agreed. See *Oscar Gruss & Son* v. *United States*, 261 F. Supp. 386, 393 (S.D.N.Y. 1966).**

Central's earnings per share would have been taxed by 5½ cents per share. The $81 million merger savings add $3.52 to Penn Central's per share earnings. It is evident that the public has no interest in whether Penn Central earns 5½ cents less per share and that even Penn Central's shareholders' interest will not be substantially affected. While the $22 million discount represents only 5½ cents per share to Penn Central stockholders, it is equal to 22% of the First Mortgage Bondholders entire claims. The Commission's valuation of the Penn Central shares at $87.50 was predicated upon anticipated earnings of $8 per share (331 I.C.C. at 689; p. 47a).

* These negotiations were conducted in secret. No New Haven bondholder or bondholder representative received notice or participated in the negotiations (Tr. 22530-32; R. Doc. #108).

** It must be recalled that the reorganization of rail transportation by "encouraging consolidation of the Nation's railroads into a 'limited number of systems'" (see *Penn Central Merger and N&W Inclusion Cases, supra,* at 492) and the strengthening of the financial position of Penn and Central were the objects of the Commission approval of the Penn Central merger. See 327 I.C.C. at 498-502.

The memorandum of the key negotiations meeting between Penn, Central and the Trustees held on November 9, 1964 shows that the Trustees and Penn Central fixed the consideration at 950,000 shares of Penn Central common stock, $23 million face value Penn Central bonds and $8 million in cash *because the Trustees considered that this consideration would be equal to $70 million,* an amount determined not from a consideration of liquidation values, but on the basis of comparative book values (NHI-9 pp. 2, 6; R. Doc. #118). The memorandum shows that the parties valued the shares at $41 per share, the then current market price for Penn stock. The parties considered that the 950,000 shares provided $38,950,000 of the $70 million consideration (NHI-9 p. 6; R. Doc. #118).

In January, 1967, hearings were held by the Commission for the stated purpose of determining whether the Agreement was "fair and equitable". (Comm. Report and Order dated Dec. 21, 1966; R. Doc. #107.) Evidence of liquidation value of the New Haven assets was offered by the Trustees who were obliged by the Agreement to urge the fairness of its terms (R-2 p. 19 §11.7; R. Doc. #50). See also *Oscar Gruss & Son v. United States, supra,* at 393. The Trustee's evidence showed a cash net liquidation value as of December 31, 1965 of $153,247,000 despite its omission of $28.4 million of value which the Commission and the Courts have held should be placed upon the New Haven's interest in the Grand Central Terminal properties (331 I.C.C. at p. 661). Consistent with their obligations under the Agreement, the Trustees, based upon a new method of valuation, offered testimony designed to show that the self-same consideration which they had agreed to in Novem-

ber, 1964 in discharge of a value of $70 million, would be "fair", at the estimated time of closing to discharge an obligation they valued at $153 million. The Commission in the Inclusion Report found an "equivalence" by assigning an "inherent value" of $87.50 per share to the Penn Central shares (331 I.C.C. at 689-90; pp. 47a-48a) and by assigning a value of $128.97 million to the assets* which still left the assets with a value of $5.3 million more than the assigned value of the consideration. See 289 F. Supp. at 427; p. 330a. The Commission then declared the values it had assigned to the assets and the consideration were close enough to be deemed equivalent** and labeled the Agreement "fair and equitable". The conclusion is inescapable that the findings of the Inclusion Report were tailored to fit the Agreement and that the Commission had not exercised its judicial functions in determining either the value of the assets or the value of the consideration, but had contrived to select from a record of some 10,000 pages those bits of evidence which would lend the color of "rationality" to the Commission's findings. The remarkable "coincidence" of the equivalence cannot otherwise be explained.

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* This total included $13 million the Commission found attributable to the New Haven's interest in the G.C.T. properties,

** The Commission stated: "As detailed earlier, we have found the liquidation value of NH to be $125 million. We have also found that the value to NH of the consideration to be received is $125 million. It is evident therefore, that the consideration is at least equivalent to the liquidation value and will, therefore, be equitable to all parties having an interest in the NH estate to approve the transaction." (331 I.C.C. at 697; p. 55a.) To date, *no* party having an interest in the New Haven estate has approved the transaction; the Reorganization Court has disapproved the transaction as put forward by the Commission; indeed the secured creditors most active throughout the proceedings have vigorously opposed the transaction proposed by the Commission.

Although the Inclusion Report was roundly rejected by both courts because of egregious errors* which the Statutory District Court held indicated an undervaluation of the New Haven assets by $45 to $50 million (289 F. Supp. at 438, 440; pp. 354a, 358a) and which the Reorganization Court held undervalued the assets by $33 to $55 million (289 F. Supp. at 465; p. 256a), both Courts rejected certain objections of the bondholders because of the respect to which Commission findings are ordinarily entitled.

On the remand, the Commission found that the New Haven's interest in the "excess income" from the G.C.T. properties should be valued at $28.89 million instead of the $13 million found in the Inclusion Report (334 I.C.C. at 39; p. 126a). This was the minimum result of the holdings by both courts and Special Master Van Voorhis (R. Doc. #59) that the Commission had erred in using "nuisance value" as one factor in the equation by which it arrived at the $13 million figure and had erred in not finding that the New Haven's interest in the G.C.T. "excess income" was 50% rather than 40%.

By making new deductions of $22.1 million from the values it has previously assigned to the assets in the Inclusion Report, the Commission contrived a method for cancelling an amount equal to the value of *all* of the non-G.C.T. errors found by both courts.** In consequence, the addi-

* Judge Weinfeld's catalog of errors is quoted in full at fn. pp. 20-21, *supra*.

** Had the Commission on remand merely corrected the $16.2 million double deduction error as directed by the Courts (289 F. Supp. at 438; p. 353a; 289 F. Supp. at 462; p. 250a; 334 I.C.C. at 40; p. 127a) and added that amount to the liquidation value found in the Inclusion Report, it would have required a price of $145.2 million (without regard to loss sharing); $5 million more than it has now required after correcting many of the other errors noted by the courts.

tional consideration found by the Commission to be due was $15.6 million, which coincidentally matched the increase in valuation of the New Haven's interest in the G.C.T. excess income. The Commission's actions were summarized by Judge Weinfeld as follows:

> "In its latest report, the Commission restored some $37.7 million in value and then reduced that amount by $22.1 million [footnote omitted]. In effect, it gave with one hand and took away with the other. The net result is it has increased the amount to be paid for New Haven's assets by $15.6 million, despite the Reorganization Court's then view that any sum below the $33 to $55 million range 'would be unfair and inequitable to the creditors * * *'" [footnote omitted] (p. 433a).

The new deductions were of a nature so arbitrary and capricious that the Reorganization Court rejected them. But the majority of the Statutory District Court was convinced that the Commission's conclusions were entitled to great respect because they were issued by an administrative agency.

It is in the light of these circumstances and this history that the Commission's deductions for so-called "abandonment delay" and "bulk sale discount" must be considered.

After discussing the questions concerning the New Haven's rights to receive its liquidation value as the minimum price permissible under the Constitution or applicable statutes, the majority of the Statutory District Court stated:

> "Because of the way the Commission has approached the valuation question, we do not feel called upon to

decide these intriguing issues. The Commission set out to fix a price that would give NH what it thought the estate could realistically hope to achieve on liquidation." (p. 410a)

The Commission was not seeking "what it thought the estate could realistically hope to achieve on liquidation". The majority had not as clearly in mind as the Reorganization Court the history of the Agreement the Commission approved in the Inclusion Report and the strained "coincidence" by which the Commission reached an equality between the value of the assets conveyed and the consideration stated in the Agreement. The majority overlooked the fact that the Commission itself demonstrated that its so-called "pricing considerations" were nothing more than deductions from liquidation value designed to preserve Penn Central's merger benefits. The majority failed to recognize the Commission was avowedly influenced by considerations of the value to Penn Central which was not free to liquidate because of its acceptance of the Commission-imposed obligation to provide the New Haven service.

The Commission justified its search for "other pricing considerations" with the following statement:

> "The liquidation value that results in this reopened proceeding exceeds the agreed price, obliging us to make a new determination as to whether the price resulting from such a valuation is fair." (334 I.C.C. at 54; p. 141a)

The Commission summarized its findings as to the "pricing considerations" as follows:

> *"Under the instructions of the three-judge court, we have found the liquidation value of NH is $162.7 mil-*

lion. We have further found that other pricing considerations require and justify a reduction of $22.1 million from the liquidation value. We find and conclude that a price that is equitable to the estate and to Penn Central results from the $22.1 million reduction, and that NH is, therefor, entitled to consideration totalling $140.6 million (exclusive of loss sharing).

The two courts which reviewed our inclusion report tentatively held that the estate was entitled to liquidation value from Penn Central as a matter of constitutional law. In addition to our prior discussion, emphasizing the law and the fairness of the other pricing considerations to the creditors, a few other comments will be made regarding the lack of fairness to Penn Central of pricing NH at its immediate liquidation value on a breakup basis. * * * *In valuing the estate, we cannot ignore the fairness to Penn Central. We do not read either section 5 or section 77 to require the fairness to the estate to be determined without regard to the public interest or to the fairness to the buyer.* * * *

The NH liquidation value is in many respects highly hypothetical insofar as Penn Central is concerned; it is a value that for the most part is unrealizable by Penn Central and frozen into the assets. *Penn Central is not free to liquidate and must continue the operation of the property in the public interest."* (334 I.C.C. at 65-66; pp. 152a-153a) (emphasis added)

The majority of the Statutory District Court never addressed itself to the significance of the quoted conclusions. Instead, they accepted Commission rationalizations which were inapplicable to the case of the New Haven. The Reorganization Court recognized that the Commission's deductions depended upon the Commission's view that the cases of *Brooks-Scanlon Co.* v. *Railroad Commis-*

sion, supra, and *Railroad Commission* v. *Eastern Texas Railroad, supra,* and the constitutional principle enunciated therein, had been overruled and that Section 1(18) of the Interstate Commerce Act granted the Commission extraordinary powers. The Reorganization Court stated:

> "As this interpretation of the applicable law is the key to the Commission's conception of the scope of its own power, which in turn underlies most of the extraordinary and unprecedented actions taken by the Commission in formulating its Fourth Supplemental Report and Order as they affect the matter of price, it is necessary to go into an analysis and discussion of the pertinent cases." (304 F. Supp. at 802; p. 287a)

The Commission rationalized its assumption of power as follows:

> "The alleged right to liquidation values derives from an alleged right to abandon; and there are *recognized limitations on the right to abandon* that in themselves limit the creditors' entitlement to the liquidation value we have computed under the court's instructions. *Under section 1(18) of the Interstate Commerce Act, the Commission is empowered to impose reasonable limitations on the abandonment right.* The pricing out of such limitations permits us to reach what we consider to be a fair price on the present record, and we need go no further. [footnote omitted]" (334 I.C.C. at 57; p. 144a) (emphasis added)

The surface plausibility of the Commission's rationalizations was pierced by the Reorganization Court and Judge Weinfeld dissenting in the Statutory District Court. The majority of the Statutory District Court finally upheld the two deductions on assumptions and conclusions which were

at variance with the Commission's actual motivations, methods and expressions as well as at variance with the evidence before the Commission.

(1) The "abandonment delay" discount

The first of the Commission's so-called "imposed reasonable limitations" is described as a "limitation on the right to abandon" (334 I.C.C. at 58; p. 145a). The Commission's explanation of this "limitation" is that after the New Haven has ceased all railroad operations,* lengthy administrative proceedings would be required by the Commission before a certificate of abandonment would be issued, thereby creating a one year delay before the liquidation program could be commenced and supposes a "freeze" of New Haven liquidation activity for that period. The effect of the Commission's "limitation" is a deduction of $15,386,000** from the price to be paid to the New Haven.

The Commission's contention is that all activities looking toward a liquidation must be preceded by a petition for abandonment under Section 1(18) of the Interstate Commerce Act and that: "We must hear the communities that would be affected by the abandonment. If there is hope of

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* After the determination by both Courts on review of the Inclusion Report that (a) the Commission was wrong in asserting that railroads operating at a deficit could be required by the Commission to continue indefinitely and (b) that the right to discontinue operations implied the right to abandon, the Commission finally conceded that "a deficit railroad has the right to stop the deficits" (334 I.C.C. at 56; p. 143a).

** On the basis of an assumed one year delay before the start of liquidation, the Commission deducts $7,946,000 for an additional discount of liquidation proceeds to present worth, $4,940,000 for preservation costs, and $2,500,000 for additional real estate taxes (334 I.C.C. at 59-60; pp. 146a-147a).

a public takeover of segments, we must allow time for the States and communities to present their plans." (334 I.C.C. at 58; p. 145a).

The inapplicability of this rationalization to the facts in the New Haven case is set forth in the Reorganization Court's opinion:

> "There was nothing in the actual facts of the case which required a hypothetical concept which included a consideration of all the legal proceedings from termination of the reorganization to completion of liquidation. Neither the hypothetical concept nor the actual case requires consideration of such legal proceedings. It was not until the Fourth Supplemental Report that the Commission hauled in by the heels the issue of the right to abandon as a condition precedent to liquidation, and used it as an arbitrary device to reduce what it found the liquidation value to be, i.e. $162.7 million, because it felt that figure was too high to be fair and equitable to Penn Central." (304 F. Supp. at 805; p. 292a)

In its 1968 decision, the Reorganization Court held that any erosion of the New Haven's 1966 liquidation value beyond December 31, 1968 would constitute a taking of the bondholders' property without just compensation in violation of the Constitution (289 F.Supp. at 459; p. 245a). The Commission did not appeal from the Reorganization Court's decision, but instead, created the "abandonment delay" discount. The Reorganization Court recognized that the Commission's deductions from liquidation value were no more than an attempt to circumvent the Reorganization Court's constitutional determination. It stated:

> "Like Laban of old, the Commission would now require further servitude of the debtor—in this case the cred-

itors. But the duty of the debtor's creditors to suffer losses for an interim period has already been served to the extent that in fairness and equity the public had any right to demand. This proposition is clear beyond doubt. The public interest may well have been overprotected. The solution most consistent with the public interest has been worked out and the I.C.C. has no power or right to require more." (304 F.Supp. at 800; p. 283a)

The Commission appears to find significance in the fact the Trustees and the bondholders did not present abandonment applications as an alternative to a sale to Penn Central (334 I.C.C. at 59-9; pp. 145a-146a). Yet the Commission concedes, as the Statutory District Court had predicted, that had such applications been presented, consideration would have been deferred "while inclusion was being explored" (334 I.C.C. at p. 59; see 289 F. Supp. at 443-4; p. 366a). Indeed in March, 1965, the Trustees *did* petition the Commission for permission to discontinue all passenger service and the Commission denied that petition because it had simultaneously ordered the sale as a condition to the Penn Central merger. In the *New Haven Passenger Discontinuance Case,* the Commission found, as of April 5, 1966:

> "There now is totally lacking any hope or plan for future survival of this carrier, except that held out by its merger into a trunkline railroad. * * * Were it not for the Penn-Central merger, it seems, a viable medium for generally restructuring the New Haven might not be evident today." (327 I.C.C. at 173).

This denial establishes that the Commission would have denied an application for abandonment of both passenger

and freight operations. The Reorganization Court repeatedly made clear that it would not entertain the cessation of New Haven operations while the possibility of a sale to Penn Central existed. See p. 104, *infra*. The Reorganization Court understood this Court to hold similar views (pp. 233a-234a).* In the Inclusion Report, the Commission found:

> "If there is one thing on this record that is clear and undeniable, it is that NH has neither earning power nor the prospect of earning power" (331 I.C.C. at 687; p. 45a).
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> * * *
>
> "The cold, hard fact is that NH has been losing money for years and that unfortunate situation continues unarrested" (331 I.C.C. at 697; p. 55a).

The proof offered by the Trustees and *Penn Central* in the 1967 hearings was of liquidation value because all recognized the New Haven lacked funds for further operations. The collapse of the New Haven had mandated its sale to Penn Central. But for the Commission's designation of Penn Central as the purchaser, the reorganization would have been dismissed and the operations terminated. The Reorganization Court, most familiar with the history of the New Haven,** emphasized these facts overlooked by the Commission:

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* The majority of the Statutory District Court considered "unthinkable" the idea of the States of Connecticut, Rhode Island and a large part of Massachusetts being without rail service (pp. 404a-405a).

** This Court has recognized the special importance of a reorganization court's findings on questions of fairness and equity. In *Reconstruction Finance Corp.* v. *Denver & Rio Grande R. Co.*, 328 U.S. 495, 533 (1946) the Court concluded: "In view of the District Judge's familiarity with the reorganization, this finding [fairness and equity] has especial weight with us."

"It is also inequitable to penalize the New Haven an additional $15,386,000 as the consequence of delaying abandonment in a hypothetical liquidation proceeding, so that the political units and representatives of the public interest could be heard, when, but for the adoption by the Trustees of a course to serve the public interest, abandonment proceedings could and would have been commenced in late 1963 and liquidation would have been started, certainly by the valuation date of December 31, 1966.

"The policy of imposing an interim burden of losses, through its deficit operation, on a railroad in reorganization is to afford a reasonable opportunity to the responsible agencies, to arrange the continuation of the railroad's operation, but the law does not require the furnishing of two or three or four opportunities. The duty was more than amply fulfilled by the New Haven. The public interest has had one huge bite of the apple; it is not entitled to another" (304 F.Supp. at 801; p. 285a).*

The majority of the Statutory District Court not only expressly declined to employ its familiarity with the facts (p. 406a),** but ignored the Commission's treatment of

* The Reorganization Court here describes its justification for imposing a burden of $70 million of interim losses on the New Haven. It is submitted that no authority exists for such an imposition. See pages 102-109, *infra*.

** In its review of the Inclusion Report the Statutory District Court had unanimously responded to Penn Central's claim that "before the NH Trustees, could even begin a liquidation, lengthy abandonment proceedings would be required", as follows: "* * * the Commission had to pick a date for valuation and December 31, 1966 was a reasonable choice. If we were to posit a liquidation beginning only some years hence, we would not simply deduct interim cash losses and depreciation but would have to ask the Commission to revalue the assets and this might yield a higher price." (289 F.Supp. at 438-39; p. 355a.) The majority of the Statutory District Court incorrectly abandoned this position in its review of the Remand Report. (p. 414a. But see p. 436a, Weinfeld, J., dissenting.)

them. The majority felt obliged to attribute to the Commission "assumptions" which were never made or required. The majority said:

> "The further adjustment in the Remand Report amounts to *assuming* that the *decision to liquidate* would have been taken on that date [January 1, 1967] but that liquidation could not begin until a year later because of the necessity for obtaining a certificate of abandonment under §1(18)"* (p. 411a) (emphasis added).

The Commission made no assumption of a "decision to liquidate"** on January 1, 1967 and there was no basis for the statement of the Statutory District Court majority that

> "The effect of what the Commission has done here is *to assume* that liquidation could have begun on January 1, 1968, a month before the PC merger occurred and NH's right to inclusion thereby accrued" (p. 413a) (emphasis added).

Since the Remand Report nowhere discloses that the Commission made such assumption, it likewise discloses no facts in support of the assumption. If the Commission intended the valuation date to be January 1, 1968 rather than January 1, 1967, deducting $3 million for depreciation

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* Even assuming that the Commission's consent is required, where all agree that there was no foreseeable possibility that the New Haven service could operate except at a loss, the Commission may not withhold its consent. *Brooks-Scanlon Co.* v. *Railroad Commission, supra,* at 400.

** The Statutory District Court does not specify whose "decision" is involved in the hypothesis. Absent the prospect of a sale of the assets to Penn Central, the Reorganization Court considered abandonment proceedings would have terminated "certainly by the valuation date of December 31, 1966" (304 F. Supp. at 801; p. 285a).

(as it did when it fixed the valuation date at December 31, 1966)* would adjust the value consistently. Instead, the Commission has deducted $15,386,000.

The fact is, as conclusively detailed in the opinion of the Reorganization Court (304 F.Supp. at 800-801; pp. 284a-285a), that during the seven and one-half years of deficit operations, the four states and the Federal Government made it abundantly clear that except for commuter services to New York and Boston, they were not inclined to take over and operate the New Haven. The Reorganization Court stated:

> "Otherwise nothing has come to the attention of this court, to indicate anything more than a highly speculative prospect, that any or all of the states concerned or their municipalities had the slightest interest in taking over and operating the New Haven or any segment of it. * * * If inclusion by the Penn Central had not been achieved and no such standby legislation had been passed, the cost of the failure of the governmental bodies to act must, according to the Commission, be chargeable to the New Haven estate to afford the governmental bodies an additional opportunity to decide whether they wish to take steps to keep all or a part of the railroad in operation." (304 F.Supp. at 800-801; pp. 284a-285a)

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* Most of the valuation testimony gave values for December 31, 1965. Penn Central offered testimony as to some values as of December 31, 1966. The Commission used a valuation date of December 31, 1966 and claimed to have deducted $3 million for depreciation to account for the difference in value of some of the property one year later (334 I.C.C. at 48-50; pp. 135a-137a). The valuation figures were adjusted to December 31, 1966 only for convenience. The adjustment did not imply that the liquidation would not already have been commenced prior to that date.

At the urging of the Commission, this Court stated:

> "* * * inclusion of the NH in the Penn-Central combination is the only possibility that has been advanced by any of the parties—including the complaining bondholders—for continued operation of NH, short of the *sheer speculation* that the States concerned or the Federal Government might take over the road and its operations." (*Penn-Central Merger and N&W Inclusion Cases, supra* at 507) (emphasis added)

The Commission now postulates a delay of a year for the indulgence of "sheer speculation" and deducts $15,386,000 from net liquidation value on that account.

The Commission, whose responsibility for the Nation's transportation system inspired its attempt to limit the price to the consideration Penn Central had voluntarily agreed to pay, fabricated the "delay for abandonment" deduction which cannot be justified on theoretical or practical grounds. No case has been cited by the Commission or the majority of the Statutory District Court which approves such a deduction. Applied to the New Haven, it is arbitrary, capricious, unfair and inequitable.

* * *

Upon the skeleton of its abandonment proceedings theory, the Commission has stretched a meaty one year delay. It has postulated a slothful administrative monster which would require a year* to validate the findings al-

* The Commission stated: "To the extent that evidence was proffered on the processing time of possible abandonment proceedings involving NH, such matters are within our knowledge and evidence thereon was unnecessary." (334 I.C.C. at 29; p. 116a) The Administrative Procedure Act provides that findings and conclusions

ready made that the New Haven had utterly collapsed.* On April 6, 1966, the Commission "simultaneously" denied the New Haven's application to discontinue passenger service and approved the Penn Central merger subject to the condition that Penn Central include the New Haven (327 I.C.C. at p. 553). This denial was a denial in form only. In effect, the New Haven was granted abandonment on condition that the New Haven sell to Penn Central and, by legal implication, at not less than net salvage value. See *Tennessee Central Railway Co. Abandonment of Operations,* 333 I.C.C. 443, 454-5 (1968). Since at least April 6, 1966, therefore, the filing of a New Haven application for complete abandonment would have been a formalistic exercise. In the light of the inclusion proceedings, it would have been denied; in the absence of the inclusion proceedings, it would have had to be granted. The New Haven is entitled to have the Commission apply methods of valuation appropriate to a determination of the New Haven's value and not methods which may be applicable to railroads with different histories.

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unsupported by substantial evidence are unlawful. 5 U.S.C. §706. We do not question the Commission's "expertise" on the subject of the delays involved in administrative proceedings—its special experience in this regard is legendary—but even Commission "expertise" must be applied to substantial evidence. See *Burlington Truck Lines* v. *United States,* 371 U.S. 156, 167 (1962).

As early as December 7, 1961, the Commission stated: " * * in the absence of any sharing of the burden [of operations] by the Federal government the debtor may be forced to cease all operations within the next two years. In that event, we are satisfied that the proceeds of liquidation would be sufficient to repay all loans guaranteed under the provisions of part V of the Act." *New York, N.H. & H.R.R. Loan Guaranty,* 312 I.C.C. 471 (1961). Thus, with regard to its duty of care for the government as creditor, the Commission specifically found the losses would not erode the government's security. It showed no similar regard for the bondholders' security.

In the *Tennessee Central Abandonment Case, supra,* the applicant, a railroad in reorganization under Section 77, filed for complete abandonment on February 12, 1968. Protests were filed, hearings held and briefs filed by April 15, 1968 and the Commission report was issued on April 25, 1968. The Commission approval was conditioned upon the applicant giving first "consideration to any offer for acquisition which contemplates continued operation * * *" and second, "at a price not less than the net salvage value of the property."

If the real circumstances of this case are considered, it is clear the Commission had conditioned a New Haven abandonment certificate upon a sale to Penn Central who would continue operations (334 I.C.C. at 60-61; pp. 147a-148a). There is then no reason to allow "time for the States and communities to present their plans" (334 I.C.C. at 58; p. 145a) and an assumed delay of one year is completely unjustified.

On the hypothesis of a liquidation with no purchase by Penn Central, a deduction from liquidation value for abandonment proceedings cannot be assigned. The need to determine the hypothetical liquadation (net salvage) value arises from the conclusion that abandonment is appropriate. The determination of liquidation or net salvage value is then required in order to ascertain the constitutional minimum which the abandoning railroad must accept from a purchaser who agrees to continue the operations. Since the decision to hold valuation proceedings follows the recognition of the right to abandon, a reduction from liquidation value for a delay for aban-don-

ment proceedings is illogical. Even if this were not so, the Commission would speed the grant of an abandonment certificate, encourage prompt offers for the dormant property so that service could be resumed.

The Commission cites the *New York, Ontario and Western Railway Co. Case* (F. D. 19861, Oct. 10, 1957) as support for its estimate of a one year delay (341 I.C.C. at 59; p. 146a). The facts in that case show that it took the Commission less than four months (including the summer months) to grant the application to abandon. The property was put up for bids before the application was made. The bid was made in June, 1957 and accepted by the seller in July, 1957. Application to the Commission was then made and it was granted on October 10, 1957. See *Kilsheimer* v. *Rose & Moskowitz,* 257 F.2d 242 (2d Cir. 1958). A period of four months between contract and closing is hardly a serious delay. The assumption that the entire liquidation program could be set back one full year by reason of formalistic Commission procedures that can only reach a known result is untenable. The Commission should be the first to deny that it would require one year to complete an empty ritual if the expense to the New Haven would amount to millions of dollars.

* * *

One component of the $15,386,000 abandonment delay discount is the further discount to present value amounting to $7,946,000 (334 I.C.C. at 59; p. 146a). This assumes that, despite the fact that New Haven operations have ceased for lack of operating funds, *absolutely nothing* will be sold for an entire year. The New Haven has been consistently able to sell more than $3 million in real estate

each year (NHI-45 p. 1; R. Doc. #119). No reason is given why that practice of selling non-operating property could not continue. The statement of the majority of the Statutory District Court that "the Commission was warranted *in assuming* that, with their serious cash stringency, the NH trustees had done about all such selling that they could" (p. 415a) (emphasis added) is factually and logically incorrect. The Commission expressed no such assumption and there is no evidence to support such an assumption. Penn Central's own witness recognized that more than $9 million in security investments could be sold in the first year (R-38 App. A., R. Doc. #50). The same is true of $12,654,100 in equipment and rolling stock which Penn Central concedes could be sold in the first year (R-38 App. A, R. Doc. #50).* Nor does the "serious cash stringency" permit an inference that all non-operating real estate had been sold. The real estate being subject to the bondholders' mortgage, the proceeds of sale would not be available to meet operating expenses. They must be placed in the Registry of the Reorganization Court subject to the bondholders' liens. The trustees surely had no motive to sell income producing non-operating real estate since such sales would deprive them of working capital to support railroad operations. When the proceeds were deposited in the Registry, the income too remained in the Registry. If the Commission had assumed all the non-operating real estate had been sold, such an assumption would not have been based upon substantial evidence.

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* Section 1(18) of the Interstate Commerce Act requires a certificate only for abandonment of a "line of railroad". There is no restriction on the sale of investments, non-operating property or equipment, and the liquidation program could, in any event, proceed with those sales.

The Commission assumes, irrationally, the New Haven, with rail operations terminated, would simply "freeze" for one year. There is no support for the conclusion that the Trustees would be so incompetent or that the Reorganization Court would permit such a foolish and flaccid administration.*

* * *

It is apparent that the "one year delay" discount is no more than an afterthought on the part of the Commission which conceals a withdrawal from its previous finding that the evidence supports the projection of a six-year liquidation period (331 I.C.C. at 663; p. 61a).** The afterthought is incomplete, for its postulates would require a discount to present value in an amount other than the $7,946,000 fixed by the Commission.

The new Commission assumptions leave an additional year for the disposition of the property, but make no adjustments on account thereof. The record is bare of evidence as to what property would remain unsold at the end of six years. The record shows only that the property left at the

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* The Reorganization Court found no need to comment on this point since it rejected the entire abandonment delay discount. Judge Weinfeld, dissenting said: "According to the Commission, the only development during that year would be a further deterioration in the financial status of the New Haven. That was not the Commission's position on the last round. Then, in observing that a large portion of the New Haven's assets consisted of land, it said: 'We cannot assume that these values will diminish. It is at least as reasonable to pre-suppose that the values will increase.' [footnote omitted] That was our position, too. We thought that '[i]f we were to posit a liquidation beginning only some years hence, we could not simply deduct interim cash losses and depreciation but would have to ask the Commission to revalue the assets and this might yield a higher price.'" [footnote omitted] (p. 437a).

** The remands did not reopen the appropriateness of the liquidation period. Neither Penn Central, the Trustees, nor the bondholders challenged the six year period in the courts.

end of five years had a market value of $11,177,632 (NHI-58 p. 13; R. Doc. #119). The Commission in the Inclusion Report discounted this value by $8,178,000, the extent it found appropriate to accomplish disposition by forced sales in *one year* (331 I.C.C. at 622; p. 20a. See also 289 F.Supp. at 428 fn. 6; pp. 332a-333a). Nor does the record disclose that any discount would be appropriate if the remaining properties were to be sold over a two year period. The $8,178,000 figure is surely inappropriate under the new Commission assumption of an additional year's delay.*

In addition, the discount of liquidation proceeds to present worth was calculated upon an assumed delay of six months after the commencement of liquidation (334 I.C.C. at 62 fn. 2; p. 149a). Such a delay would not occur if one postulated a one year wait for the completion of abandonment proceedings. During that one year period there would be not only the liquidation of investments, non-operating properties and equipment referred to above, but the completion of arrangements for the disposition of all those properties assumed to be disposed of in the first year by the six-year liquidation study. The effect of the one year abandonment delay introduced by the Commission would be to eliminate the six-months delay. The Commission discounts to present worth become incorrect if the abandonment delay theory is accepted even in part.

* * *

The Commission next adds to the $7,946,000, the sum of $4,940,000, allegedly for "preservation costs" (334 I.C.C.

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* The bondholders argued unsuccessfully to both courts that the $8,178,000 final year discount to accommodate the assumption of a six-year liquidation period was excessive and improper especially since the write-down results in an excess of expenses over proceeds in the final year. (See 289 F.Supp. at 428 fn. 6; pp. 332a-333a).

at 60; p. 147a). The figure was excerpted from an exhibit entitled "Summary—Estimated Costs of *Temporary* Cessation of Operations *With No Liquidation of Properties*" (R-43, R. Doc. #50) (emphasis added).* The exhibit indicates the estimated cost of undertaking to "mothball the fleet' (Tr. 28680-81, R. Doc. #47).** But the "abandonment delay" hypothesis presented by the Commission does not contemplate a "temporary cessation of operations". The Commission has conceded that operation of the deficit New Haven could not be compelled (334 I.C.C. at 56; p. 144a) and the hypothesis assumes that there will be no further operations by the New Haven, but only by a purchaser from the New Haven. Therefore, the cessation, as far as the New Haven is concerned, is not temporary but permanent, even on the Commission's assumptions. The New Haven is under no obligation to "mothball the fleet" for a buyer who may never appear, nor would it. It would sell everything other than the "line of railroad" for which there were buyers. The cost exhibit relied upon by the Commission did not provide for the payment of either interest or principal on equipment obligations (Tr. 28675, R. Doc. #47) and the equipment creditors would foreclose on the

* After objections by the bondholders, this exhibit was placed into evidence with the *caveat* that it was not being offered for the truth of its statements, but only to show what the Trustees relied upon in making their plans (Tr. 28796-98, R. Doc. #50). The limited introduction of the document was required because no witness to support it was presented for cross-examination. The exhibit could not be "substantial evidence" as to preservation costs; it was *no* evidence at all on that point.

** The exhibit was described by Trustee Smith as contemplating "keeping the road in shape for a period of time with the idea that it might be in part or entirely acquired by another railroad" including maintenance of the rails, roadbed, electrical connections and equipment and the mothballing and protection of both passenger and freight cars (Tr. 28680-81, R. Doc. #47).

equipment and the rolling stock, leaving the New Haven virtually without locomotive and cars to "mothball". See *Zirn* v. *Hanover Bank,* 215 F. 2d 63 (2d Cir. 1954). Only the sum of $1,250,000 represents the costs of *protection* for the New Haven properties (R-43, R. Doc. #50). The "temporary cessation" figures used by the Commission as "preservation costs" are not relevant to a railroad company whose operations have ended forever.

In addition to overstating the cost figures, the Commission irrationally contemplates that *absolutely no income* will be received by the New Haven during the delay year. But earlier in the Remand Report, the Commission, following the direction of the courts, found that the New Haven owned a 50% interest in the "excess income" from the G.C.T. properties without regard to whether or not the New Haven operated the railroad (334 I.C.C. at 38; p. 125a). The New Haven's 50% share of the income was approximately $1,328,861 for 1967 and $2,049,042 for 1968.* In addition, the liquidation study showed that during the first year of the liquidation, the New Haven would still be receiving $1,000,000 of non-G.C.T. rental income (NHI-58 pp. 14, 15 R. Doc. #119). Surely at least that amount of income must be anticipated during a one year period prior to commencement of the liquidation.** The Commission was

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* These two figures make up the $3,377,903.07 required by both courts to be paid by Penn Central (304 F.Supp. at 1137; p. 314a and p. 449a). See also p. 130, *infra.*

** During 1965, for example, the New Haven received $257,093 in rents from Bronx warehouses, $1,413,098 in miscellaneous non-operating property rental income consisting of many small items, $164,538 in dividend income from securities owned, $153,560 in interest from mortgages, promissory notes and temporary cash investments, plus $396,975 in interest from invested reserve funds (NHI-30 p. 9, R. Doc. #119).

clearly wrong in failing to deduct estimated income from estimated costs.

* * *

The next "delay cost" added on by the Commission is $2,500,000 for one year of additional accruals of real estate taxes (334 I.C.C. at 60; p. 147a). Here again, unless the New Haven "froze", sales of real estate would be accelerated at the commencement of the second year, reducing the real estate taxes required in the second and following years of the six year liquidation.

Indeed, if the concept of the delay year is accepted but the untenable notion that the New Haven could take no steps toward liquidation in the delay year is rejected, the liquidation schedule of receipts and expenses must be recalculated completely.

* * *

The majority, confronted by these evident miscalculations of the impact of a year's delay on the liquidation value of the New Haven, acknowledged the errors but made no effort at correction. It assigned as its basis for declining relief the availability of other means by which the Commission could reduce the price to be paid by Penn Central.* The majority stated:

"The bondholders contend that sales contracts could be made on a contingent basis, that only sales sched-

* Whether this remarkable result derived from the majority's unwillingness to remand again a proceeding which would then surely come before it for a third review, or whether the majority felt that on remand, the Commission would find ways to achieve its preconceived objective while appearing to bow to the mandate of the Court, the majority's failure to require a remand for the correction of acknowledged substantial errors is improper.

uled for the first year would be delayed; and that the preservation costs would be less than estimated particularly since holders of defaulted equipment obligations would repossess. *While these arguments are not without persuasiveness, they are offset* by the Commission's failure to deduct a further year's depreciation of some $3 million, by the conservativeness of the estimate that one year would suffice for an abandonment proceeding of such magnitude and possible judicial stays, and by the Commission's choice of January 1, 1968 as the date for beginning liquidation instead of imposing on NH the costs of an additional year's delay in order to arrive at the possibly more logical starting date of February 1, 1969." [footnote omitted] (pp. 415a-416a) (emphasis added)

Clearly the arguments recognized as persuasive cannot be offset on the basis of unrelated considerations, some of which the Commission rejected and others of which it never dreamed.

The first "offset"—that the Commission did not deduct an additional $3 million for depreciation—is completely illogical. As the majority itself later notes, $2.367 million of the depreciation relates to equipment (pp. 426a-427a fn. 9) and this is the very same equipment the majority admits would be repossessed because of defaulted equipment obligations. If the equipment was repossessed, the Commission would be obviously wrong in deducting for depreciation. Moreover, a $3 million deduction for depreciation would have represented the total impact on the liquidation proceeds if the Commission had chosen to adjust the valuation of the assets to December 31, 1967. See pp. 72-73, *supra*.

The second "offset"*—that the Commission could just as well have calculated a two-year abandonment delay period because of the "magnitude" of the abandonment proceeding "and possible judicial stays"—cannot be countenanced. Here the majority unconsciously substituted its own judgment for that of the Commission. The majority had already declared that the one year delay period was reasonable and should be sustained. In order to offset the miscalculation of many millions of dollars it recognized the Commission made, it calculated that the impact on liquidation value of a longer delay might equal the amount of the errors. But the total of the errors had never been calculated. Whether the sum of the errors would be substantially "offset" by the impact of a further delay absolutely depended upon the extension of the liquidation for a longer period than the Commission deemed reasonable and the majority accepted.**

The "one year delay", belatedly injected into the proceedings by the Commission, is an abuse of power which cannot be justified. The calculation of the cost of the "one year delay" at $15,386,000, is improper, inaccurate and not based upon substantial evidence. This Court should affirm the Reorganization Court's holding that the "abandon-

* While the majority appears to distinguish between the "conservativeness of the estimate that one year would suffice" and the "Commission's choice of January 1, 1968 as the date for beginning liquidation", it is clear the points are indistinguishable and simply involve the stretch out of the abandonment delay beyond one year.

** The majority's suggestion of February 1, 1969 as the date which describes the delay which "would have occurred after the right to inclusion accrued" is not supported by any evidence. See p. 416a fn. 4. In fact, the New Haven transferred its assets to Penn Central on December 31, 1968. There is no logical basis for attaching any significance to the New Haven's "right to inclusion" while considering valuation on the basis of a hypothetical liquidation.

ment delay" discount is not a proper pricing consideration or method of valuation. If it does not, it must nevertheless remand to the Commission the recalculation of the discount with instructions sufficient to guard against the danger that the Commission, as it has before, will reconsider its findings in a manner designed to nullify the corrections.

(2) The "bulk sale" discount

The second major deduction from net liquidation value resulted from the imposition by the Commission of another so-called "reasonable limitation on the abandonment right" which the Commission claimed to derive from Section 1(18) of the Interstate Commerce Act (334 I.C.C. at 57; p. 144a). The Commission considered that the existence of Section 1(18) was an impairment of the property values of railroads since it constituted a "limitation on the right to break up the railroad" (334 I.C.C. at 60; p. 147a). The deduction from liquidation value amounts to $6,695,000 (334 I.C.C. at 62; p. 149a).

The Reorganization Court rejected the discount as an unconstitutional imposition (304 F.Supp. at 798-799; p. 281a) and as violative of Section 77 of the Bankruptcy Act (304 F.Supp. at 806; pp. 292a-293a). As will be shown, the majority of the Statutory District Court rejected the discount as unconstitutional if based upon a power derived from Section 1(18) of the Interstate Commerce Act. Judge Weinfeld rejected the bulk sale discount "because it deprives the bondholders of the salvage value of their property anticipated under the six year liquidation program and at once raises constitutional issues" (p. 438a). In

spite of the unanimous rejection by the four judges of the Commission's reliance upon Section 1(18) as providing a basis for the deduction, the majority of the Statutory District Court developed new theories and assumptions which it attributed to the Commission, and on that basis upheld the deduction.

The Commission justified the $6,695,000 deduction from liquidation value with the following legal analysis:

> "The liquidation value urged by the creditors assumes not only the immediate right to abandon, discussed above, but also the right to break up the railroad and sell the parcels for their highest and best price. We think such a right may be restricted when a buyer for the entire bulk of the NH properties appears who will continue the operation of needed services." (334 I.C.C. at 60; p. 147a).
>
> • • •
>
> "• • • we may compel the bulk sale and the bulk sale discount as a condition of an abandonment certificate, and, therefore, as a reduction of the present price." (334 I.C.C. at 61; p. 148a).

But the majority rejected the analysis as follows:

> "We entertain the gravest doubt concerning the legal premise underlying this argument; we would suppose that the constitutional right to abandon operations implies a right to break up the railroad and sell the parcels for their highest and best prices." (p. 417a)

Since the Commission's expressed unconstitutional assumption of power was thus rejected, to sustain the result the majority of the Statutory District Court was required to fit bits and pieces of Commission language to-

gether to construct an analysis it attributed to the Commission. The majority stated:

> "However, the Commission also stated 'The bulk-sale discount merely reflects a market appraisal of the risks that the estate avoids, and the bulk buyer assumes,' 334 I.C.C. at 61, and that the discount 'fully recognizes, without conceding, NH's right to abandon and liquidate the estate.' 334 I.C.C. at 63. While the Commission's language is not pellucid, we read this as saying that the Commission deducted the discount as a proper measure of risks not taken into account by the appraisals and the discount to present value." (p. 417a)

The Commission's language "is not pellucid" to the majority because it was looking for something that was not there, was never intended by the Commission to be there and could not be based upon the evidence. The majority extracted the phrase "fully recognized, without conceding, NH's right to abandon and liquidate the estate" from the middle of a conclusory paragraph which refers to the entire $22.1 million reduction and which does *not* treat the "bulk-sale discount" as a correction to the appraisal evidence.*

The majority recognized that the only evidence in the record supporting even the general theory of a "bulk sale" was that presented by Mr. Robert Simon, a real estate operator. It rejected the Commission view that Mr. Simon's

* The entire paragraph is as follows: "The limitations that lawfully may be placed on the creditors' rights to abandon and to break up the property justify reduction of at least $22,081,000 in the price. This reduction is fair and equitable to the creditors. It fully recognizes, without conceding, NH's right to abandon and liquidate the estate. The net price after such reductions simply deducts from the price the equitable equivalent of the creditors' rights to less than an immediate parcel-by-parcel breakup of the railroad." (334 I.C.C. at 63; p. 150a)

testimony was germane to the Commission's expressed assumption of the power to compel "a bulk sale and the bulk sale discount."* The majority then developed a theory of its own on the basis of Mr. Simon's testimony. Apart from the impropriety of the majority's substituting its rationalization for the Commission's, its reasoning is incorrect and inapplicable to the New Haven.

Mr. Simon presented a general opinion as to the manner in which a "wholesale" buyer of real estate in bulk would calculate his financing costs and profit, thereby arriving at the discount from fair market value that would be necessary to attract a wholesale buyer.** The majority incorrectly described Mr. Simon's testimony as follows:

> "The burden of this [Mr. Simon's testimony] was that the appraisals of a sale of land in some 1700 parcels over a six-year period, discounted merely by 6% did not reflect certain elements of risk in such an undertaking, notably the likelihood that the liquidation might take longer than estimated and the possibility of an economic downturn, even though the appraisals had substantially marked down land remaining unsold at the end of the fourth year." (p. 416a)

and further incorrectly concluded

> "* * * the Commission deducted the discount as a proper measure of risks not taken into account by the

* The majority stated: "Moreover we fail to see the relationship of this [the Commission's] argument to Mr. Simon's testimony, which was not at all concerned with a buyer 'who will continue the operation of needed service' but rather with one who would do precisely what the NH estate proposed to do." (p. 417a)

** Mr. Simon described his testimony as relating to "a single purchaser of property who would, in turn, sell off the property probably to many users and who would obtain his profit by reason of its purchase and resale." (Tr. 29828, R. Doc. #9)

appraisals and the discount to present value." (p. 417a)*

Mr. Simon never saw any of the valuation study exhibits or the appraisals and never even read the testimony of the valuation or appraisal witnesses. (Tr. 29858-60, 29878, R. Doc. #49). He did not know how much or what property was owned by the New Haven or what states it was in (Tr. 29865, R. Doc. #49). He clearly stated that he expressed no opinion as to whether or not the general principles he was enunciating "would or should be applied to any situation involving the New Haven Railroad" because he was "not familiar" with that transaction (Tr. 29855, R. Doc. #49). Not only did Mr. Simon not attempt to discern what risks were or were not "taken into account by the appraisals", but his testimony was predicated upon an assumption that the appraisals were reliable (R-29 p. 3, R. Doc. #50; Tr. 29832, R. Doc. #49).** In fact all that Mr. Simon had

* The Remand Report, however, does not suggest that the Commission was substituting Mr. Simon's findings for its own as expressed in the Inclusion Report. Without the clearest statement that the Commission intended such a substitution, the majority may not assume it has been made.

** It should be noted that several different appraisers were used by the Trustees for different properties. Those separate appraisals were adopted by the Commission. Mr. McCann appraised the Harlem River Branch properties in New York (NHI-51, 52, 53, R. Doc. #119); Mr. F. Lawrence Dow of the firm of Dow & Condon appraised certain property in New Haven, Connecticut (NHI-45 p. 32, R. Doc. #119); Mr. Mason of the firm of Meredith & Grew, supervised the appraisal of 8,384.95 acres and 8 buildings in Massachusetts, 2,206.36 acres and 1 building in Rhode Island, 11,206.36 acres and 9 buildings in Connecticut, and 2,833,21 acres and 1 building in New York (NHI-58 p. 6, R. Doc. #119), but did not appraise the B&P property or the property of the leased lines, or Massachusetts property in Springfield, from Falmouth to Woods Hole, and from New Bedford to the end of the line (NHI-58 p. 6, R. Doc. #119). The latter properties were appraised by Mr. Thompson (Tr. 23509-10, R. Doc. #110). No appraiser suggested that all these properties could be treated as a single "bulk" tract appropriate for unified development.

been told was that the real estate appraisals had been discounted to present worth on the basis of a six percent rate (Tr. 29860, R. Doc. #49). His opinion was that a wholesaler would require a greater discount to justify the cost of financing (Mr. Simon used a 9% rate), the *wholesaler's* profit on his own investment (Mr. Simon used a 15% rate), and the risks of a delay or market downturn.

Unless market value is redefined to mean the sale by a seller at a price which would insure a 15% profit to the buyer if the future were looked at as threatening only downturns, and not the price a willing seller would accept and a willing buyer would pay based upon "upside" and "downside" possibilities, Mr. Simon's testimony was irrelevant. The Commission did not place upon Mr. Simon's testimony the gloss added by the majority. The Commission recognized there was a market for the property which would yield, on a break-up basis over six years, the liquidation values it found in the Inclusion Report. In the Inclusion Report the task of liquidation was left to the New Haven, the cost and expenses of liquidation were charged to the New Haven and the risks and contingencies were charged to the New Haven.* Mr. Simon's testimony says nothing more than that he would not be willing to do the job assigned to the New Haven unless he were paid a substantial fee. The New Haven does not desire to be relieved of

* The Commission applied its new percentage discount to the net selling price of the land, after subtracting "land expenses" of $18,228,000 (334 I.C.C. at 62; p. 149a) based upon projected New Haven expenses including overhead, real estate department expenses, taxes, brokerage commissions, appraisal fees and promotion expenses (NHI-58 App. A, R. Doc. #119). In addition, at least $1 million for "contingencies" and a massive final year discount of $8,178,000 anticipating the possibility of forced sales to meet the six year deadline (331 I.C.C. at 662, 667; pp. 20a, 25a), are included.

the task at such an expense and the Reorganization Court has said it would not permit such a waste of the estate's assets. Mr. Simon's charge is not based upon the risks the estate avoids and a "bulk buyer" would assume. It is based instead upon the fact that real estate experts insist on being paid handsomely for their work. Mr. Simon's charge would recompense him for supervising the very same staff whose expenses were charged by the Commission to the New Haven. Mr. Simon's expenses are a duplication and unjustified unless by the addition of his management service one could reasonably expect the liquidation of the properties would yield more than the total of the net liquidation value found by the Commission plus Mr. Simon's profit.

Mr. Simon's testimony was too hypothetical to justify the majority's characterization of it or the majority's conclusions in respect of it. The real bulk buyer would not expect a seller to be willing to sell at a discount from conservative appraisals. He would inspect the appraisals to determine whether they were pessimistic or optimistic. A bargain could be struck only if the buyer were willing to meet the seller's price because he saw something in the appraisals which satisfied him that he could and likely would, receive more than the appraisals suggested.

The majority opinion and the Commission opinion do not meet because the Commission found in Section 1(18) of the Interstate Commerce Act the power to make an unwilling seller of the New Haven. The majority rejected the Commission's assertion of that power and then proceeded to justify the discount as if the power existed by looking at the price it would take to make an unwilling

buyer willing. Net liquidation value looks to the price a willing buyer would pay and a willing seller would accept.*

The majority, which had the Reorganization Court's opinion before it when it spoke, ignored the role of the Reorganization Court in respect of the administration of the debtor's assets. The Reorganization Court held it could not countenance a discount sale to a speculator under these circumstances:

> "Further the bulk sale deduction violates the fair upset value minimum for sales of a debtor's property, as provided in §77(b)(5), because 'fair upset value' is the lowest price the debtor's estate could accept for the properties. That lowest price is what the market would pay, which is implicit in the standard used here, i.e. fair liquidation value. *Neither a trustee nor an equity receiver could, with the court's approval, sell for less.*" (304 F.Supp. at 806; p. 293a) (emphasis added)

The majority ultimately sustained the "bulk-sale discount" by stating:

> "* * * we can hardly find it irrational for the Commission to have concluded that it would be imprudent

* The definitions of "net liquidation value" and "market value" used by the witness whose appraisal the Commission accepted were: "By the term 'Net Liquidation Value' I mean the aggregate net recovery value of the real estate which it is reasonable to expect over a projected period, *after deductions from the current market value to reflect the cost of holding, managing and selling the real estate during the marketing period.* 'Market Value' as used herein * * * is defined as follows: 'The highest price estimated in terms of money which a property will bring if exposed for sale in the open market, allowing a reasonable time to find a purchaser who buys with knowledge of all the uses to which it is adapted and for which it is capable of being used.'" (NHI-58 pp. 5-6, R. Doc. #119) (emphasis added). The Commission rejected appraisals offered on a "forced sale" basis (331 I.C.C. at 668; p. 26a).

for the NH estate to take this risk [of market downturns] over a period of six years." (p. 418a)

The Commission expressed no such conclusions; no evidence was presented that there was such risk of a real estate market decline that prudence required the New Haven Trustees to sell at a discount; the Commission is not qualified to rule on the legal question of the limits of prudence required of reorganization trustees; and the Reorganization Court, which is exclusively charged with the supervision of the Trustees, has ruled that it would be *imprudent* for the Trustees to sell to a middleman at a price below the fair market value. If the New Haven were actually liquidated, the Reorganization Court alone, not the Commission nor the Statutory District Court, would determine the question of prudence.

The bulk sales discount of $6,695,000 must be rejected because it is a discount from net liquidation value and therefore unconstitutional. It cannot be justified by reliance upon Sections 1(18) and 1(20) of the Interstate Commerce Act as the Commission supposed. It is inconsistent with the method of valuation elected by the Commission for the New Haven real estate. It is an improper and illogical method of valuation. It interferes with the Reorganization Court's functions in respect of the supervision of the debtor's assets.

B. The Courts, having properly determined that the Commission erred in concluding that payment of $83.1 million of the minimum price required by the Constitution was satisfied by the delivery of 950,000 shares of Penn Central common stock, erred in failing to require payment in securities having a cash value of $83.1 million.

In both the Inclusion Report (331 I.C.C. at 688-690; pp. 46a-48a) and the Remand Report (334 I.C.C. at 68 fn.40; p. 155a), the Commission approved the payment by Penn Central of $83.1 million of the purchase price in the form of 950,000 shares of Penn Central common stock.

Trustee Kirk testified he believed the market price of the stock would fluctuate between $75 and $100 per share at the time of transfer of New Haven's assets to Penn Central, then estimated to be in 1970.* The Trustees suggested that the stock should be valued at $87.50 per share. The Commission, believing that the stock market's tendency to look to future earnings would result in a market value of $87.50 per share at the time of closing, declared that 950,000 Penn Central shares would discharge $83.1 million of Penn Central's obligation. (331 I.C.C. at 688-690; pp. 46a-48a; see 289 F.Supp. at 437; pp. 351a-352a).

The bondholders objected on the ground the shares should be valued of even date with valuation of the assets (December 31, 1966). The value of the assets would fluctuate between the valuation date and the time of closing, but the New Haven would receive no more if its assets were in fact worth more at the time of closing. Fair-

* The witness's testimony did "not reveal the basis for this belief" (289 F. Supp. at 437; p. 351a).

ness required the Penn Central shares to be valued as of December 31, 1966. The Commission nevertheless attempted to anticipate the market value of the shares at closing. The bondholders then argued that while they considered it was improper to value the assets transferred by the New Haven as of one date and the assets transferred by Penn Central at another, it was decidedly wrong to estimate the price at which Penn Central shares would trade several years later. Penn Central shares were widely traded in a free, fair and orderly market and the New York Stock Exchange would definitely reflect the true market value at the time of closing. Where an error of almost $1 million results from every dollar by which the Commission's estimate has missed the target, approximations should be avoided lest the sellers do not receive just compensation or the fairness required by Section 77 of the Bankruptcy Act. An estimate was especially reckless where, as here, the date of closing was uncertain. The bondholders urged there was no need to guess even if the Commission's standard of market value at time of closing was selected; the actual number of shares to be delivered could be computed from an average of prevailing prices for Penn Central's shares around the time of closing. The Reorganization Court succinctly summarized the bondholders' contentions and the significant figures relating to Penn Central shares at the relevant dates:

> "The bondholders assert that fairness and equity require that the value should have been based on the market value of December 31, 1966—the valuation date for everything else—or on the average market for a reasonable period of time before the date of closing. The average market price on December 30, 1966 (the last trading date of 1966) was 52⅜. The closing price

on December 31, 1968 was 63⅜. The average of the high and low prices for November and December 1968 was 62.81. The bondholders claim it is unfair to charge the New Haven's estate with having received $83.1 million when the form in which it was received could be acquired on the open market for about $20,000,000 less." (304 F. Supp. at 809; p. 299a)*

When the Inclusion Report issued, the date of closing was indefinite. When the Commission issued the Remand Report, however, it simultaneously directed the transfer of the assets free and clear of liens to take place on December 31, 1968 (334 I.C.C. at 76; p. 163a). The Remand Report was dated November 25, 1968, only one month before the closing date. It was apparent the Commission's earlier estimate was wrong by approximately $25 million, but the Commission did not alter the equation and mentioned the subject only in a footnote. See 334 I.C.C. at 68 fn.40; p. 155a fn.40.

The closing date (December 31, 1968) passed prior to completion of judicial review of the Remand Report. On review, both courts recognized that it was grossly unfair to the New Haven to treat 950,000 shares as adequate consideration to discharge $83.1 million of the purchase price.

The Reorganization Court held:

"There is an element of unfairness, however, in the fact that the New Haven has transferred assets con-

* On the closing date, December 31, 1968, the stock closed at $63⅜. The value of the 950,000 shares was, therefore, $60.21 million or $22.89 million *less* than the credit granted to Penn Central. Since at least December, 1969, the shares have been selling at roughly $30 per share. The present value is therefore about $28.5 million or $54.6 million less than the credit.

servatively worth what the liquidation value says they are worth. The purchase price, to the extent of $83.1 million and fully credited to the purchaser as $83.1 million paid, is not worth $83.1 million on the present market. It is credited as $83.1 million paid, on an assurance or assumption that the 950,116 shares will be worth that sum and more, but when and who will make good on that assurance is not known or not stated. The ordinary purchaser of shares of stock takes it subject to his losing or gaining on the money he put into it. But the New Haven is not that kind of purchaser; it is being *compelled* to take it at a substantial present loss on the assurance of future gain." (304 F.Supp. at 809; pp. 299a-300a) (emphasis added)

The Reorganization Court then attempted to cure the unfairness and inequity by requiring "a supplemental provision fulfilling the implicit promise by the purchaser to pay $83.1 million as part of the price for the assets conveyed." (304 F. Supp. at 809; p. 300a)

The majority of the Statutory District Court held:

"• • • *in the last analysis the market is the true appraiser* and, if anticipations, no matter how well founded, should not be achieved, a proper adjustment should be made. We find Judge Anderson's solution of this difficult problem to be admirable and direct that the order be modified as provided in his opinion." (p. 430a) (emphasis added)

The Reorganization Court's "supplemental provision" may be generally described as a qualified underwriting by Penn Central of the price of $87.50 per share as of Febru-

ary 1, 1978.* But the underwriting does not provide the equivalent to which the New Haven was entitled upon the transfer. At best, the New Haven is given an unsecured, inchoate claim which would not be discharged in full, if at all, in the event Penn Central became insolvent before February 1, 1978. Except as to the $33.6 million face amount of Penn Central bonds delivered as part of the consideration (334 I.C.C. at 71; p. 158a; see also p. 272a), the New Haven is not even given the equivalent of a purchase money mortgage on its own property. If the New Haven presently had shares which could be sold at a price which would yield $83.1 million, it would not be compelled to rely on the ability of Penn Central to discharge its obligations in cash in 1978.

Even with the underwriting formula, which the Commission and Penn Central have accepted, crediting the

* The principal terms of the provision are as follows: "If at any time the market price of Penn Central common shares reaches and maintains 87½ per share on the New York Stock Exchange for a period of five consecutive days on which the Exchange is open and doing business (not counting days on which the Exchange is closed to trading) between the date of final consummation of the Plan of Reorganization and February 1, 1978, then and in that event it will be conclusively presumed that Penn Central has, in transferring the shares to the New Haven, made payment of the $83.1 million of the purchase price represented by the shares. If, however, the common shares of Penn Central do not reach and maintain the price as aforesaid, then the value of the shares will be determined by the average of the means between high and low prices of Penn Central shares on the New York Stock Exchange for the 30 business days next preceding February 1, 1978, on which the Exchange is actually operating and there are sales of Penn Central shares. Penn Central will forthwith become liable to pay in cash to the New Haven, or its successor or successors, the difference between said mean market prices of those 30 days and 87½ for each share of the block of 950,116 shares." (304 F. Supp. at 1138; pp. 318a-319a). The Decree of the Statutory District Court also spells out the terms in some detail (pp. 449a-452a). The Commission, in its modified Fifth Supplemental Report, accepts the concept of the stock underwriting. (334 I.C.C. at 532; p. 226a)

shares at $83.1 million remains grossly unfair to the New Haven. Because the consideration provided is intended to be the minimum constitutionally permissible, the New Haven's rights under the Fifth Amendment are infringed.

Judge Weinfeld, dissenting, recognized the unfairness. He stated:

> "The New Haven estate is entitled to the equivalent of $83.1 million as part of the purchase price. After hearing the parties upon a remand, the Commission may require the issuance of a larger number of shares or otherwise provide for that sum." (p. 441a-442a)

Judge Weinfeld has touched the central unfairness of the formula proposed by the Reorganization Court; it does not provide the "equivalent of $83.1 million as part of the purchase price."

By reason of the underwriting, the date for the valuation of the stock has been advanced to February 1, 1978,* but, unlike the method used for valuation of the assets, the proceeds have not been discounted back to present value and the expenses of sale have not been deducted. While the underwriting formula, *if adequately secured,* avoids depriving the New Haven *permanently* of the full value of the consideration, it nevertheless deprives the New Haven of interest at least at the prime rate on the difference between $83.1 million and the market value at December 31, 1966 of

* This is subject to the "five day provision" which terminates the underwriting presumably on the theory that the 950,000 shares could be sold at $87.50 during the five day period. The provision has the practical effect of preventing any sales at less than $87.50 for fear that the underwriting will terminate and the New Haven will never realize $83.1 million.

the Penn Central shares from January 1, 1969 until such time as the underwriting is fulfilled or terminated and the New Haven has received its full price.

Had the Commission suggested that Penn Central could pay a portion of the price on closing and a portion of the price at a later date, it surely would have required interest to be paid on the unpaid balance. It would also have given the New Haven a security interest in the assets transferred, until the balance was paid.* The formula fails to provide for the loss of interest and leaves the underwriting a general unsecured obligation.

The substantial expense of selling 950,000 shares should not be imposed on the New Haven. It was charged with selling expenses incident to a determination of the net liquidation value of its assets. The New Haven will receive the equivalent of net liquidation value only if the selling expense is borne by Penn Central.

Whatever form the consideration is to take as a matter of convenience to Penn Central,** the New Haven is entitled to receive the full equivalent of $83.1 million.

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* The bonds Penn Central has delivered as part of the consideration are divisional mortgage bonds.

** The reason offered by the Reorganization Court for accepting the consideration in the form of shares—that Penn Central will be relieved "of the need to divest itself of a crippling amount of cash" (304 F.Supp. at 809; p. 299a)—is adequately answered by simply requiring the payment to New Haven of a sufficient number of shares of stock to achieve a liquidation value at closing of $83.1 million (1,586,786 shares at $52⅜ per share) plus the selling expenses. The bondholders continue to contend that the stock should have been valued as of December 30, 1966, the valuation date of all the other property. Valuation on the basis of the closing date would require delivery of 1,309,664 shares at $63⅜ to equal the required $83.1 million. A second reason offered—that the New Haven will be afforded "an opportunity to participate in probable future profits" (*id.*) —is answered by the Reorganization Court itself in recognizing the New Haven could have acquired the "opportunity" on the closing date at $63⅜ per share rather than $87.50 (*id.*).

If Penn Central were required to pay monthly interest at ½% above the prevailing prime rate on the difference between the value of the shares at December 31, 1966 and the date when the market establishes shares could be sold to realize $83.1 net after expenses of sale* and the New Haven were given a mortgage adequately securing the underwriting, the major inadequacies of the underwriting formula would be overcome. The interest should run from January 1, 1969.

C. The Commission's failure to provide compensation for erosion of $70 million of bondholders' security for the public benefit, except for $5 million of loss contribution, is unfair, inequitable and unconstitutional.

In the name of the public interest in continued rail service the Commission and the Reorganization Court compelled the erosion of approximately $70 million of the bondholders' security. Except for $5 million of loss sharing by Penn Central, no compensation was provided. Although the New Haven was compelled to operate until Penn Central could conveniently assume New Haven operations, the Commission provided no compensation for going concern value. In these respects, the price set by the Commission is unfair, inequitable and unconstitutional.

(1) The unconstitutionality of the $70 million compulsory erosion

From the start of the reorganization proceedings in July, 1961, the Reorganization Court recognized the New Haven's record of deficit operations compelled the conclusion that no reorganization of the New Haven as an operat-

* When the shares traded above $87.50 for 60 consecutive trading days it would be fair to terminate both the interest and the underwriting.

ing railroad was feasible because the revenues did not and could not be expected to equal the expenses even if all of the fixed charges for bonded indebtedness were eliminated. Nevertheless, the reorganization proceedings, in usual fashion, restrained the mortgage bondholders from foreclosing their lien.

The railroad was able to continue operations from 1961 through 1968 only because it borrowed funds and deferred the payment of its bills.* 289 F. Supp. at 458; p. 244a. See also *New Haven Passenger Discontinuance Case, supra,* at 167.** These borrowings and deferments have resulted in the accumulation of some $70 million in administration claims entitled to priority over the first mortgage. (334 I.C.C. at 126; p. 213a).†

The erosion was the result of unreasonable official compulsion. The Commission denied the New Haven's attempt to reduce the deficits by discontinuance of passenger service. *New Haven Passenger Discontinuance Case, supra.*

* The Commission was aware of the erosion of the estate. In a footnote in the Inclusion Report, it explained: "To speak only of the NH's 'operating losses' obscures the matter. The interests of the NH bondholders stem primarily from their liens on the NH assets. Losses which reduce the value of the assets or represent deferral of expenses that have a prior claim on the NH estate weaken the interests of those creditors. Thus, *the creditors are hurt when cash expenses exceed cash income* resulting in an attrition of the current assets available to pay priority claims on the estate *and by the deferral of payment* of real estate taxes, per diem charges in dispute, and tort claim liabilities having the status of administrative expenses. (331 I.C.C. at 703-704 fn. 33; pp. 61a-62a) (emphasis added). See also footnote, p. 75, *supra.*

** The Commission here stated: "Since 1961 there has been a serious and continuing erosion of equity to the extent of an $81.7 million * * * deficit as of December 31, 1965."

† See 334 I.C.C. at 126; p. 213a. The $63 million shown in the Remand Report does not reflect 1968 operations.

The Reorganization Court, while enunciating the constitutional limitations of Section 77 of the Bankruptcy Act, continued to conclude that the boundary of unconstitutional appropriation had not yet been reached. (See Mem. Oct. 20, 1961, Cert. R. Doc. #3; Mem. Mar. 5, 1962, Cert. R. Doc. #5; Mem. Feb. 15, 1965, Cert. Doc. #10; Mem. Oct. 24, 1966, Cert. R. Doc.#17). The Reorganization Court denied in February, 1968 the April 1967 petition of the Bondholders Committee to dismiss the reorganization proceedings. *In re New York, New Haven & H.R.R.*, 281 F. Supp. 65 (D. Conn. 1968); (p. 229a). Each time the constitutional question prompted by the erosion of the bondholders' security was raised, it was held the question was premature because until the terms of sale were finally determined it could not be known that the bondholders were permanently damaged.

The Commission, in the Inclusion Report, rejected the claim that the bondholders were entitled to the value of the New Haven undiminished by erosion after December 31, 1963. (331 I.C.C. at 698; p. 56a). The Commission also rejected the bondholders' protest that the issuance of first priority Trustees' Certificates and their repayment by a purchase price credit against delivery of the New Haven assets was unconstitutional. The Commission summarily stated:

> "We consider such a result part of the process of distributing the burdens of the NH's operations. It is a fundamental aspect of our free enterprise economy that private persons assume the risks attached to their investments, and the NH creditors can expect no less because the NH's properties are devoted to a public use." (331 I.C.C. at 704; p. 62a).

In denying the Bondholders Committee's petition to dismiss the reorganization proceedings, the Reorganization Court stated:

> "In any event, the cross-petitioners will have ample opportunity to present their claims of lack of due process and a taking of their property without just compensation before the reviewing courts, because, if the evidence in the record of the case before the I.C.C. shows without contradiction that the Commission's order is in violation of the bondholders' constitutional rights, it cannot stand, and the approved plan certainly cannot be found to be fair and equitable." (p. 234a)

The Commission provided no compensation for any of the erosion from the commencement of the Section 77 proceedings to February 1, 1968, the date of the Penn Central merger. The Commission has been upheld by both the Statutory District Court and the Reorganization Court. The Reorganization Court defined the applicable constitutional principle as follows:

> "* * * as bondholders of a railroad their interests are subject to such invasion as may be essential to continue the operation of the railroad for a reasonable period of time to provide an opportunity to work out a permanent plan or means of continuing the operation, if possible, *to the extent that it is required by the public interest.*" (289 F. Supp. at 455; p. 240a) (emphasis added)

The Statutory District Court declared:

> "Although we agree that by investing in a railroad the bondholders did not surrender their constitutional right not to be required to operate the property at a perpetual loss, *they did subject themselves to such interim losses as are reasonably incident to working out*

the solution most consistent with the public interest." 289 F. Supp. at 443-444; p. 366a) (emphasis added)

Both definitions deprive the bondholders of the constitutional safeguards enunciated in the Fifth Amendment. The definitions do not disclose when the constitutional limits have been reached, either in time or money. But the erosion permitted, and indeed commanded here, exceeded by $10 million the value of the 950,000 shares of Penn Central stock on the closing date. On its face, such erosion is not "such interim losses as are reasonably incident to working out the solution most consistent with the public interest" or "such invasion as may be essential to continue the operation of the railroad for a reasonable period of time." It must be supposed that both courts meant the erosion which could be constitutionally imposed must be reasonable not only in time but in amount. If indeed the Fifth Amendment permits the erosion of property without compensation if it is for a "reasonable time" in a "reasonable amount," the erosion of the New Haven estate must be held to exceed the bounds of "reasonableness."

Whether the Bankruptcy Clause of the Constitution (Art. I, Sec. 8 par. 4) is viewed as having as its purpose the protection of creditors or the relief of debtors, its purpose was not to tax either in the public interest. See *Continental Illinois Nat. Bank* v. *Chicago, Rock Island & Pac. R.R.*, 294 U. S. 648, 667-674 (1935). Section 77 of the Bankruptcy Act was intended for use where a *recapitalization* would make possible the survival of a railroad necessary in the public interest. Since no recapitalization was possible, the erosion which took place during the course of the Section 77 proceedings was neither in the interest of the creditors nor

the debtor. The proceedings were merely a device through which the creditors and the debtor were taxed in the public interest. As applied here by the Courts and the Commission, constitutional provisions intended for the protection of the debtor and the creditors have been used to their detriment. Section 77 was unsuitable to the New Haven's circumstances. It contains no provisions permitting the erosion of the estate through deficit operations and would be unconstitutional if it did because the powers of Congress to establish "uniform laws on the subject of bankruptcies" (U.S. Constitution, Art. 1, Sec. 8 par. 4) and the powers of the Federal Courts to administer those laws, are limited by the due process and "just compensation" requirements of the Fifth Amendment. *Louisville Joint Stock Land Bank* v. *Radford*, 295 U. S. 555, 602 (1935); *Continental Ill. Nat. Bank* v. *Chicago, Rock Island & Pac. Ry. Co.*, 294 U. S. 648 (1935). See also, *In re Third Ave. Transit Corp.*, 198 F.2d 703, 707 (2d Cir. 1952).

While both the *Radford Case* and the *Continental Bank Case* recognize that the powers of a bankruptcy court may be exercised to delay the enforcement remedies of a mortgagee, neither case permits the surrender of the mortgagees' security for the benefit of the public interest. The mortgage bondholders of a railroad are not less protected by the Fifth Amendment than bank mortgagees whose rights were vindicated in the *Radford Case.** The

* The Statutory District Court itself recognized this principle when it cited the cases of *Louisville Joint Stock Bank* v. *Radford*, *supra*, and *Wright* v. *Mountain Trust Bank*, 300 U. S. 440 (1937) as declaring "* * * that while Congress may in the public interest subject a secured creditor to reasonable delays in *realizing on his security*, it may not deprive him altogether of his right to sell the *res* at public auction." (p. 408a) (emphasis added)

reference of both courts to the fact that the bondholders are creditors of an enterprise essential to the public interest does not indicate why their constitutional rights are thereby diminished. As a matter of policy their rights should be cherished since a strong, privately-owned and operated rail system demands that the lender to railroad enterprises be at least as well protected as the lender to enterprises not required in the public interest. Moreover, the clear interest of the public in railroad enterprises makes it simple for the public to exercise its rights to condemn, paying just compensation.

This case dramatically illustrates the impropriety of continuing a reorganization proceeding where erosion is certain. The imposition of "interim losses" may quickly exceed the losses contemplated and may stretch out far beyond the contemplated "interim" period.*

Here the "interim" was limited to seven and one-half years only because the Reorganization Court finally concluded that the limits of the constitution had been reached.

"* * * this court finds that the continued erosion of the Debtor's estate from operational losses after

* The Reorganization Court acknowledged:

"By late 1963 it was clear to the Trustees of the New Haven and to the Reorganization Court that only two courses were open: the Trustees must press to accomplish the inclusion in a Penn Central merger or they must press for liquidation. The former was obviously in the public interest and the latter was not. The course of inclusion was followed; but because the merger and the reorganization proceedings stretched out far beyond what was originally forecast, the 'interim' became seven and a half years; and 'losses reasonably incident to working out the solution most consistent with the public interest' eroded the debtor's estate in excess of $60 million." (304 F. Supp. at 800; p. 283a). See footnote †, p. 103, *supra*.

the end of 1968 will clearly constitute a taking of the Debtor's property and consequently the interests of the bondholders, without just compensation," (289 F. Supp. at 459; p. 245a).

The constitutional limits were, in fact, reached at least by December 31, 1963. Perhaps the public is entitled to a "ride" until a solution that suits the public is worked out; it is not, however, entitled to a "free ride."

The Commission's failure to include compensation for the erosion is unconstitutional, unfair and inequitable. By merging, Penn Central agreed to pay the fair and equitable price to which the New Haven is entitled. If Penn Central paid for the erosion in 5% bonds, at the ratio fixed by the Commission, Penn Central's annual earnings would be diminished by approximately 18 cents per share, pre-tax. The merger savings are projected to produce $81 million per year, or $3.52 per share.

(2) The failure to require Penn Central to assume New Haven losses after the Penn Central merger

Even if the Constitution or standards of fairness and equity could be held to deny the New Haven relief from erosion to the date of the Penn Central merger, it was improper for the Commission not to require Penn Central to bear the New Haven losses following the merger.

By July, 1967, the New Haven was near to the point where railroad operations would terminate for lack of cash to pay employees and to purchase supplies (see Mem. Dec. 7/11/67, Cert. R. Doc. #21). In its Inclusion Report, therefore, the Commission devised a scheme for "interim

upport" which would make available cash funds to enable the New Haven to continue to operate in the public interest (331 I.C.C. at 699-721; pp. 57a-79a). The scheme required Penn Central to lend cash to the New Haven. The loans were secured by first priority Trustees' Certificates bearing interest at the prime rate and were to be repaid by delivery of the New Haven's assets as a credit against the purchase price. The scheme also provided that the loans would be offset by an amount calculated by application of a formula to the New Haven's operating losses. The formula provided, subject to a maximum of $5.5 million in any one year (the amount estimated by the Commission to be equal to all the anticipated formula losses for the first year following the Penn Central merger), for an offset of 100% of the formula losses in the first year and a declining percentage of the formula losses in the next two years ("loan-loss formula"). (331 I.C.C. at 718-719).*

The Commission offered the following justification for the loan-loss formula:

> "We believe that, short of an immediate takeover of NH operations, *the interim support loan for which we are here prescribing terms will assure continuity of NH service and best serve the public interest.* At the same time, our concurrent approval of the 'first step' of the trustees' general proposal for a plan of reorganization—the sale of the NH assets to Penn-Central—will facilitate the quick and absolute takeover of the NH operations that the public and private interests,

* These provisions were outlined by this Court in *Penn Central Merger and N&W Inclusion Cases, supra,* at 509-510, 552-559.

properly weighed, require." (331 I.C.C. at 706; p. 64a) (emphasis added)*

• • •

"We have heretofore discussed the *vital need for continuation of the NH's services* and the importance of including the NH in the Penn-Central system as soon as possible. We believe that by *requiring all interested parties to share in the operating losses of the NH during the interim period we can best accomplish our objective.* If any of these parties should not cooperate during this period, the NH might be unable to continue service causing serious injury to the economy of New England, and, indeed, adverse effect on the affairs of the Nation as a whole." (331 I.C.C. at 715; p. 73a) (emphasis added)

In the "interim period"—February 1, 1968 through December 31, 1968—New Haven borrowed $14 million from Penn Central and spent it to support operations. (334 I.C.C. at 72; p. 159a.) Against this, the Commission has allowed New Haven a credit of only $5 million (11/12 of the $5.5 million maximum). (334 I.C.C. at 74; p. 161a). When the Commission stated in November, 1968 "But for the Penn Central loan arrangement NH would long since have gone under" (*Id.*), it avoided the significant facts. The Commission should more properly have said "But for the sacrifice of the bondholders' property NH would have long since gone under." The New Haven was required to pay interest on Penn Central's loans currently

* When the bondholders attacked the concept of the "two step" plan on the grounds that the approval of a sale price and the transfer of the assets by the Reorganization Court would be equivalent to utilization of the "cram-down" clause in Section 77(e) of the Bankruptcy Clause without a vote, the Court of Appeals called the attack "premature". *In re New York, New Haven & H.R.R. Co.* (*Chase Manhattan Bank* v. *Smith*), 378 F.2d 635 (2d Cir. 1967).

(thereby increasing the erosion). At the closing, Penn Central repaid itself by withholding a portion of the purchase price. Absent relief here the sum can never be recovered by the New Haven or its bondholders.

Although the Commission in the Inclusion Report contemplated that the New Haven would be relieved of the burden of the first year's losses, it provided no further relief when its estimates proved incorrect. The Commission said:

> "In the *inclusion* report we explained that the burdens of the interim period prior to inclusion should in fairness be borne in part by the States, in part by Penn Central, and in part by the estate. The events of the intervening months do not convince us that we should impose NH's entire operating loss for 1968 on Penn Central, nor have the courts required that result." (334 I.C.C. at 74; p. 161a)

The events of the intervening months should have convinced the Commission to remove the $5.5 million limitation and that Penn Central should bear the 1968 losses.

The latest New Haven cash statement in the record—for eight months actual and four months estimated in 1968—indicates New Haven's *cash deficit* for 1968 at *$15,672,000* (R-3, R. Doc. #50; 334 I.C.C. at 72; p. 159a). By projecting a five months 1968 operating statement, the Commission computed a "formula" loss for the year at $8.2 million (334 I.C.C. at 73; p. 160a), an error of $7.4 million.*

* The "formula" excludes rental for leased roads and equipment and interest on equipment, which the Commission erroneously states "are more nearly capital charges" (331 I.C.C. at 718; p. 76a). These charges, which would not be incurred except for the requirement of continued railroad operations, amount to approximately $2.6 million annually (*id*).

Whereas the Inclusion Report showed that the Commission recognized fairness required that the New Haven be relieved of substantially all the operating losses for the first year following the merger, the Remand Report, by woodenly holding to the $5 million maximum contribution in the face of the fact that the losses exceeded $11 million, demonstrated that in its concern to preserve the lowest price to Penn Central, the Commission was prepared to ignore considerations of fairness to New Haven. The Commission's persistence arbitrarily increased the share of the losses the New Haven must bear by at least $6 million.*

As the Commission readily admits, the "interim" loan provisions were designed to accomplish the Commission's "objective," namely, the avoidance of serious injury to the economy of New England and an "adverse effect on the affairs of the Nation as a whole" (331 I.C.C. at 715; p. 73a). The Commission's "imposition" of a share of the losses for the benefit of the public on Penn Central was accepted voluntarily by Penn Central; the "imposition" of a share on the States was, of course, voluntary on the part of the States and moreover the proper function of a state; the imposition of a share of the losses on the New Haven bondholders was a *true* imposition and placed an unconstitutional burden upon the bondholders for the benefit of Penn Central, of the citizens of the New England states, and the Nation.

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* Judge Weinfeld dissenting, disapproved of the loan-loss formula and stated: "Had that which should have been done, been done at the time of the merger, New Haven then would have become a unit of Penn Central, with the latter necessarily absorbing operating losses from the date of the merger; to require Penn Central to do so now imposes no unjust or onerous terms upon it. Penn Central, as the beneficiary of the merger, would be assuming a burden which was part of a single transaction * * *" (289 F. Supp. at 418; p. 378a).

As declared in *Armstrong* v. *United States,* 364 U. S. 40 (1960)

> "The Fifth Amendment's guarantee that private property shall not be taken for a public use without just compensation was designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole." (364 U. S. at p. 49)

(3) The failure to provide compensation for the New Haven's going concern value

The exercise of excessive power by the Commission and the Reorganization Court to force the continued operation of the New Haven until its assets could be transferred to Penn Central was of substantial financial benefit to Penn Central. If the New Haven ceased operations Penn Central would not thereby be relieved of its obligation to provide the New Haven service. The continuation of deficit New Haven operations up to the very day of the transfer of assets enabled Penn Central to fulfill its obligation without having to expend the funds that would be required to start up New Haven service after a cessation of operations. The New Haven had, over the years, expended substantial sums for organizational costs, engineering expenses, training of personnel and development of operations and the uncontradicted testimony is that the New Haven's intangible assets should be valued at $55 million (NHI-104 Appendix A, R. Doc. #123). On the grounds of the probability that the New Haven in its present form "would never be built today," the Commission reduced the value of these assets to $5.5 million (331 I.C.C. at 685; p. 43a) but required no payment from Penn Central because it considered the valuation of these intangible "going concern" assets to be inconsistent with the liquidation value assumption (331

I.C.C. at 686-7; pp. 44a-45a). The Statutory District Court agreed and held that it would not follow the standard of just compensation provided in the case of *Port Authority Trans-Hudson Corp.* v. *Hudson Rapid Transit Tubes Corp.*, 20 N.Y. 2d 457, 285 N.Y.S. 2d 24 (1967), *cert. denied*, 390 U. S. 1002 (1968). (289 F.Supp.at 435; pp. 374a-348a). This was error.

Although these intangible assets would be worthless to the New Haven in an assumed liquidation, they have substantial value to Penn Central or any other purchaser of the New Haven's property for continued operation. The New Haven was improperly required to preserve these assets until takeover, yet Penn Central was absolved of payment.

The case of *Matter of City of New York (Fifth Avenue Coach Lines)*, 18 N.Y. 2d 220, 273 N.Y.S. 2d 52 (1966) involved the condemnation of an operating bus transportation system which had shown no profit for many years prior to the condemnation. The New York Court of Appeals stated:

> "These going concern attributes or so-called intangible assets such as coach routes, operating schedules operating records and systems of procedures and trained personnel make it possible for the city to operate the transit system the day after the condemnation. Under the theory erroneously followed below, the assets in which the owners of the bus systems had invested substantial sums could be taken without compensation. *These assets, without which the city could not have operated the system, can no more be taken without compensation than can its tangible corporate property.*" (18 N.Y. 2d at p. 221, 273 N.Y.S. 2d at 56-57) (emphasis added).

In *Port Authority Trans-Hudson Corp.* v. *Hudson Rapid Tubes Corp., supra,* the New York Court of Appeals remanded for the taking of evidence on "going concern" value, which it described as follows:

> "* * * the cost of organizing and systematizing the enterprise, such as the cost of developing operating schedules, operating records, systems of procedure and the training of personnel. To the extent that unprofitability is evidence of inefficient organization that factor must be considered in determining the award." (20 N.Y. 2d at 472, 285 N.Y.S. 2d at 33)

These and other similar benefits to Penn Central were achieved only because the Commission and the Reorganization Court forced the New Haven to continue operations, at an enormous cost to the bondholders by erosion of their security, until the assets could be transferred to Penn Central. The Commission plainly said:

> "Our *prime* purpose in requiring inclusion of NH in the merged Penn-Central system *is to assure continuity of NH service* (which we have found essential to the public) *as an integrated part of the Penn-Central system* and under the system's management." (331 I.C.C. at 653; p. 11a) (emphasis added)

* * *

All of the force of the powers of the Commission, the Reorganization Court and indeed, this Court, were employed to assure continuity of New Haven service and the integration of that service in the Penn Central system. "The primary consideration is the public interest, and in the present context, the continuation of NH service *without interruption* is a public interest matter of paramount im-

portance." (334 I.C.C. at 76; p. 163a) (emphasis added). Penn Central received benefit along with the public by the continuity of service without interruption; the rights of the bondholders were pushed aside to be dealt with when the public interest "emergency" was over. The Commission stated:

> "The choice is clear: *either the public at large is forced to stand in the wings awaiting progress in transportation* while the NH creditors haggle on stage over the wasting corpus of the NH estate, *or*, on the other hand, *the overall objectives of the law are served, with the broad public interest brought into the scene in the form of improved service through a consummated Penn Central merger including an operational NH*, while the NH creditors are freed to litigate at will the distribution of their estate.
>
> It is true that a carrier proposal approved under section 5(2) may, in a particular case, be only one of many possible just and reasonable plans which might be advanced for the purpose sought to be achieved. *This case is different. Here both the inclusion transaction and the terms for it are pursuant to a Commission prescription made in particular reference to the NH's posture;* and with the trustees, we believe that *any terms prescribed* under section 5(2) *to meet the unique and critical situation* of this case should be devised as well to satisfy section 77 of the Bankruptcy Act." (331 I.C.C. at 653-54; pp. 11a-12a) (emphasis added)

If the Commission had a "choice", the bondholders had none. The Commission, recognizing that Congress had not yet provided funds necessary to satisfy the "broad public interest" in rail transportation, constituted itself a legis-

lative body and "prescribed" the result without respect for the bondholders' rights and the mandate of the Fifth Amendment. The Commission's fiery rhetoric is misplaced. The Fifth Amendment does not prevent property from being taken for a public purpose. It only requires the Government to pay just compensation to the owners or to require payment by Penn Central, the company that has elected in this case to assume the governmental function.

III

The Courts erred in sustaining the Commission's failure to require Penn Central to pay any consideration for the transfer to it of the New Haven's share of the income from the Grand Central Terminal real properties formerly utilized by the New Haven to pay for its share of the station expenses.

One of the most important questions in these proceedings has been the nature and value of the New Haven's interest in the huge real property development located in the heart of New York City which has been referred to throughout these proceedings as the "Grand Central Terminal Properties" or "G. C. T. properties" or "Park Avenue properties". The Commission (331 I.C.C. at 679-684; pp. 37a-42a; 334 I.C.C. at 30-39; pp. 117a-126a), the Reorganization Court (289 F. Supp. at 462-463; pp. 251a-253a), Special Master Van Voorhis (Spec. M. Rep., R. Doc. #59) and the Statutory District Court (289 F. Supp. at 428-433; pp. 333a-343a) all agree that the New Haven is the owner of a valuable interest in this real estate venture that would survive liquidation of the railroad. The bondholders disagree with

the Commission's conclusion that the New Haven's right to that portion of the income from the properties that has heretofore been applied to the payment of the New Haven's share of expenses ($5.6 million annually) "is valueless" (334 I.C.C. at 32; p. 119a) and must be forfeited to Penn Central without compensation to the New Haven.

The phrase "Grand Central Terminal" is not the same as "Grand Central Station". The "Terminal" properties include not only the station and railroad facilities, but the entire land area extending roughly from 42nd Street to 53rd Street and including Madison Avenue (in part), Park Avenue (in toto) and Lexington Avenue (in part).* It consists of approximately 19 parcels of commercial real estate upon which are built such world famous buildings as the Pan Am Building, the Waldorf-Astoria, Commodore, Biltmore, Roosevelt and Barclay Hotels and the Yale Club in addition to the modern, multi-story office buildings that line both sides of Park Avenue. The properties were appraised in these proceedings as of April 19, 1965 at $227,255,000. (NHI-19, R. Doc. #118). That appraisal was accepted by all parties. The Commission has required Penn Central to pay $28.4 million (334 I.C.C. at 39; p. 126a) to oust the New

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* The Special Master stated: *"The Grand Central Terminal properties*, exclusive of the Terminal building itself, *are not connected with the operation of either railroad.* They were made possible by compliance with Chapter 425 of the Laws of 1903 and Chapter 69 of the Laws of 1904 enacted by the New York State Legislature requiring these tracks to be put below ground between 42nd and 57th Streets and Madison and Lexington Avenues and railroad operations over them to be electrified. This eventually resulted in converting a smoky railroad ditch, shunned by all who could afford to keep away from it, into one of the most famous and sought after of streets anywhere." (Spec. M. Rep. p. 10, R. Doc. #59) (emphasis added).

Haven from its equal partnership position. Both courts have affirmed the Commission.*

The appraisal of $227,225,000, however, was not utilized by the Commission (or the Courts), which undertook to value the New Haven's interest on the basis of a capitalization of the New Haven's share of estimated future income in excess of the estimated future expense of the operation of Grand Central railroad station, treating as an item of expense, *Penn Central's costs in operating the New Haven service into the station.* The Commission's attempt in the Inclusion Report to value the New Haven's interest at $13 million (331 I.C.C. at 679-684; pp. 37a-42a) was found to be erroneous by both courts. The Commission, after the remand, found that the G.C.T. income was $18,400,000 per annum, derived from four general sources developed by the joint venture (a) income from leases and franchises in the station itself (referred to by the Commission as "Terminal Revenue"); (b) income from office buildings, primarily

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* In earlier state court proceedings the New Haven had been described as an equal partner with the Central in these non-operating properties. *New York Central R.R. Co.* v. *New York, New Haven & H.R.R. Co.*, 13 A.D. 2d 309, 216 N.Y.S. 2d 928 (1st Dept. 1961), *aff'd mem.*, 11 N.Y. 2d 1077 (1962) (Biltmore Case). The lower court in the *Biltmore Case*, interpreting the agreements between the New Haven and Central stated: "Is it reasonable to believe that sound, practical, hardheaded railroad executives representing New Haven some 50 years ago would have agreed to a business proposition resulting in its joint financing with Central of 18 buildings in the Grand Central Terminal area, whereby it would commit itself to such large and expensive investments, assuming 50% of the risk of loss and no share of profits, only the return of its investments with interest, while Central, sharing the risk of loss, would take the entire profit? The court would be naive to assume that the present heads of these railroads possess greater business acumen than did their predecessors of half a century ago." 24 Misc. 414, 425, 208 N.Y.S. 2d 605, 615 (1960).

under net leases; (c) net profits from the five hotels;* and (d) miscellaneous income (referred to by the Commission as "Other Income") (334 I.C.C. at 39; p. 126a).

As a result of procedures broadly described in 1907 and 1913 agreements between the New Haven and New York Central, the G.C.T. income from the various sources was historically deposited in a common account referred to as the "Terminal Account". (Spec. M. Rep. pp. 13-14, R. Doc. #59). Under the terms of the agreements the New Haven was obligated to pay a proportion (based upon its proportion of car entrances—considered by the Commission and all parties to be 41%) of the fixed charges on the financing of the cost of construction of the previous depot and the new station, and the cost of operating and maintaining the new station and the railroad facilities (289 F. Supp. at p. 429). These expenses were paid initially from the New Haven's share of the income flowing into the Terminal Account and the balance due was then paid in cash by the New Haven. The result would have been the same had the New Haven's share of the G.C.T. income been paid over to it entirely, with the New Haven then paying its full share of the terminal costs and expenses in cash. The New Haven's annual share of costs and expenses averaged $5.6 million per year out of total annual expenses of $13.6 million (334 I.C.C. at 32; p. 119a). Commencing with the year 1964, the total G.C.T. income exceeded the total expenses. After 1963, therefore, the New Haven's share of expenses —$5.6 million—and the Central's share of expenses—$8

* The railroads own five hotels; they operated four themselves through a wholly-owned subsidiary, Realty Hotels, Inc., while the Waldorf-Astoria is operated by a lessee.

million—were paid out of funds flowing into the Terminal Account, and an "excess" of income was accumulated.*

The Commission and the Courts have held that the New Haven owns a 50% interest only in the so-called "excess income" and that Penn Central need pay only the capitalized value of that interest in exchange for acquiring all of the rights and interests of New Haven in the G.C.T. properties. The Commission has computed total annual income at $18,400,000 and total expenses at $13,850,000; leaving "excess income" of $4,550,000. New Haven's 50% share is $2,275,000 which, capitalized at 8%, equals $28,438,000, the sum Penn Central is required by the Commission to pay (334 I.C.C. at 39; p. 126a).**

It is clear, however, that as a result of the sale transaction, Penn Central receives the *entire* annual income of $18.4 million, which sum includes the $2.275 million for

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* The Special Master stated: "The passenger railroad operations of the New Haven have, after many prosperous years, turned out to be a dismal failure economically. Upon the other hand, the Grand Central Terminal non-operating properties have been a spectacular success." (Spec. M. Rep. p. 44, R. Doc. #59).

** Despite the testimony of witnesses for both the bondholders and Penn Central as to future capital expenditures and testimony that future profits would increase by approximately $2.5 million over average 1964-1967 hotel income, the Commission rejected all the testimony, assumed that future increased capital expenditures would "wash" and not increase profits, and used an average of past income for 1964-1967 as indicative of future income (334 I.C.C. at 35-38; pp. 122a-125a). On Penn Central's projection of capital expenditures the income would increase by $1.4 million. Because the Commission rejected all projections of future hotel income the valuation of New Haven's share of excess income is undervalued by at least $700,000 which, at the capitalization rate utilized in this case, amounts to $8,750,000. This resulted in an erroneous and excessively conservative valuation of the New Haven interest in the "excess income". See generally, *Protective Committee for Independent Stockholders v. Anderson*, 390 U. S. 414 (1968).

which compensation is provided and the $5.6 million previously used by the New Haven to discharge its obligations arising from its use of the station, for which no compensation is provided. When, in reviewing the Inclusion Report, the Reorganization Court remanded, it said:

> "In addition, it is suggested that the Commission consider and make findings as to what value, if any, attached to New Haven's present right to share in the income for the purpose of defraying its cost of operating in and out of the terminal. Whether an authority will take over New Haven's commuter operations and succeed to this right, which the New Haven now has, or Penn-Central succeeds to that right, a valuable interest will have been acquired." (289 F. Supp. at 463; p. 253a).

The Commission evaded the Reorganization Court's request. Instead of attempting to compute the dollar value of the valuable interest to be acquired by Penn Central, the Commission turned the inquiry around and concluded: "In liquidation the right to free use of the terminal would have no value to NH unless there were a buyer willing to pay for such use." (334 I.C.C. at 32; p. 119a).

This statement is predicated on the motion that a fair description of the New Haven's interest is "free use". The use became "free" only because the income from the properties increased spectacularly so that the New Haven, by applying its share of the income, was not required to pay its share of the G.C.T. expenses from income generated elsewhere. The Commission does not deny the obvious fact that Penn Central acquired a valuable interest. It ignores the fact that Penn Central, however unwillingly, by its merger undertook to operate the New Haven service, there-

by signifying its willingness to bear the burdens involved for the overall merger benefits to be derived.

Forgetting that its own order guaranteed continued operations of New Haven service into the terminal, the Commission considered the question purely hypothetically and said:

> "The only potential buyer in sight is the State of New York which would not need to bid for free use of the terminal * * * the State of New York would need to pay for only the *net cost of operating into the terminal.*" (334 I.C.C. at 34; p. 121a) (emphasis added).

Nevertheless, the Commission made no attempt to fix the net cost of operating into the terminal which "the State of New York would need to pay" and the payment of which would, at least, increase the amount of "excess income". The Commission avoids the point by concluding that the State of New York is in a position improperly to use its bargaining leverage to avoid payment of a fair rent. (334 I.C.C. at 32; p. 119a). The Commission has no right to impute bureaucratic arrogance to New York State and, of course, there was no evidence that the State of New York would not bargain in good faith.

The Reorganization Court concluded that the Commission's determination should stand.* It stated "While

* In its "step II" opinion, the Reorganization Court stated: "The ultimate value of New Haven's interest in the Grand Central Terminal properties might far exceed that which this court has found. Take, for example, only one item, although a major one, and that is the value of New Haven's right of access to the Grand Central Terminal, which the I.C.C. found to be of no value—a determination which this court finally concluded in its Memorandum of May 28, 1969, could not be disturbed, although in its opinion of August 13, 1968 (289 F.Supp. 451, at 463), it was of the view that on remand

mitigation of a burden may in some circumstances furnish a consideration, it is not a measurable one for the purpose of this issue in the case." (304 F. Supp. at 806; p. 294a).

The Statutory District Court recognized the "significant benefit to Penn Central" of succeeding to "NH's right to have its share of terminal expenses met by income from GCT properties." It pointed to the uncertainties that a buyer could be found and the amount he would pay (pp. 419a-420a). The Court said:

> "While we do not disagree with the bondholders' position that a state must pay the salvage value of property of a defunct railroad, *what is the 'salvage value' of property that cannot* be sold to anyone else and is of no *value in the owner's hands?*" (emphasis added)*

The Reorganization Court should not have concluded that it was permissible to assign no value to so substantial a benefit because it was not readily measurable. Nor should the Statutory District Court have concluded that there was no "salvage" value in the New Haven's interest because it could not be "sold to anyone else" when, in the circumstances of this case, Penn Central had demonstrated by its

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the I.C.C. shall reconsider on the basis that the New Haven's right was valuable. If on appeal the existence of such a right were to be recognized, the evidence presently in the record would show a potential worth of approximately $70 million." (304 F. Supp. at 1124; pp. 314a-315a).

* The anti-assignment provision of the G.C.T. agreement could not prevent the transfer of the rights to the income. Any fair interpretation of Section 70(b) of the Bankruptcy Act (11 U.S.C. §110 (b)) wounld permit a bankruptcy trustee to affirm the agreements and then assign the interest, especially when the alternative is the absolute forfeiture of property rights worth $70 million. The Statutory District Court's statement that the right to the income "cannot be sold to anyone else" is incorrect.

merger that it was willing to pay the price of assuming operations to achieve merger. The Statutory District Court, while conceiving of the State of New York as a possible purchaser or condemnor, appears to consider that because the New Haven passenger operations were at a loss, the State, if it desired to operate the service, would not be required to pay anything for the New Haven's right to have income applied to its share of expenses. It is submitted that the law in New York State is otherwise. The recent case of *Port Authority Trans-Hudson Corp.* v. *Hudson Rapid Tubes Corp., supra,* makes clear the principle that it is unfair for a condemnor to acquire the benefits involved in taking over an operating essential service without payment therefor, even though the service was being run at a loss and the condemnee could not otherwise have recovered these benefits. The New York Court of Appeals stated:

> "We are here concerned with a property which has a usefulness created by the owner himself through the expenditure of large sums of money and by the continued operation of the property for the very purpose for which the petitioner is acquiring the property. * * * This owner has developed its property at a cost of millions of dollars and operated it for more than 50 years. It is admittedly of great usefulness in the daily transportation of thousands of commuters. A condemnor should not be permitted to tell him: 'It's only worth scrap or less.'" (285 N.Y.S. 2d at 30)

The lesson of the *Port Authority Case,* is that the New Haven must be paid for every benefit Penn Central receives as a result of New Haven's development of its property.

By conceiving that the benefits of the New Haven could pass to the State of New York or Penn Central without compensation because the passenger service is operated at a deficit, the Statutory District Court effects a forfeiture of $70 million ($5.6 million capitalized at the 8% rate used in these proceedings). The *Port Authority Case* recognized that just compensation required a separation of the fact of deficit operations from the useful value which inhered in the property.

The bondholders, in respect of the evidence of the New Haven's interest in the G.C.T. properties, proceeded on the basis that they were equal partners in the proceeds of sales of the G.C.T. properties and entitled not only to 50% of the "excess income" but to a vested right in that portion of the income theretofore used to defray the New Haven's share of expenses relating to the G.C.T. properties and the New Haven's share of the station expense. On December 31, 1966, the valuation date, had all the G.C.T. real estate been sold, the New Haven would have been entitled to one-half of the net proceeds of sale. Admittedly, these sales could not take place unless both the New Haven and Central agreed, but the New Haven's consent alone, and its right to withhold that consent, was a valuable asset. When the Commission designated Penn Central to purchase the assets of the New Haven, the New Haven was in full possession of the right to agree or not to agree to the sale of the G.C.T. properties. It was a full partner. Further, if the Commission had not permitted Penn Central to discharge its obligation to pay for the New Haven assets with shares and bonds rather than cash, Penn Central could have raised the cash by agreeing with the New Haven to the sale of the G.C.T. real estate, utilizing Penn Central's share of the

proceeds of sale for such purpose and the New Haven would have realized at the same time its share of the proceeds of sale. As a result of the assumption that the liquidation would have worked a forfeiture of the New Haven's right to consent or withhold its consent to a sale and New Haven's right to its share of the proceeds of sale, Penn Central is now free, at one stroke, to realize all of the share the New Haven would have realized had the G.C.T. real estate been sold on or before the valuation date.

The Commission put forward this extraordinary proposition in order to deliver to Penn Central, without payment therefor, the $5.6 million of income the New Haven had regularly contributed, so as to reduce the burden to Penn Central of carrying the deficits to be anticipated from the imposition upon it by the Commission of the obligation to provide the service the New Haven had formerly provided and to prevent reduction of the anticipated $81 million of annual merger savings of $5.6 million. Since, however, the Commission could always relieve Penn Central of the obligation to perform the service if the states did not assume the burden, the net effect of attributing no value to the New Haven's interest in the income flow except for the "excess income," was to impose permanently upon the New Haven creditors the burden of sustaining railroad operating deficits to the extent of $5.6 million per year.

In fact, within one year after the transfer of the New Haven properties to Penn Central, the burden of the New Haven West End Commuter operations into New York City is in the process of being lifted from the shoulders of Penn Central by New York State and Connecticut. The opinions of the Statutory District Court and the Reorganization

Court had all recognized the possibility that the states would in fact relieve Penn Central of the obligation to conduct the West End Commuter service but determined the possibility was too speculative to be valued. The importance of the New Haven service which persuaded the Commission to compel Penn Central to perform the service as a condition of the merger would have remained equally important had the Commission not imposed condition 8. In liquidation, a concept which assumes that the New Haven would not have to continue to provide the service, the states would surely have condemned in order themselves to provide the service. Even if it is argued that such a condemnation was not absolutely certain, the prospect of such a condemnation was substantially probable. The attribution of no value to this palpable opportunity is arbitrary and capricious.

The Statutory District Court, arguing that the New Haven should not receive the entire $5.6 million free of any obligation to contribute to the fixed charges and expenses of the G.C.T. properties (p. 419a) declined to provide that the New Haven was entitled to receive that portion of the $5.6 million that would not be needed to meet the New Haven's contribution to the fixed charges and expenses. It was error to hold that because an argument might be made against the New Haven's receiving the capitalized value of the entire $5.6 million, the Commission was nevertheless correct in failing to compensate the New Haven for any part of the $5.6 million.

To hold that the New Haven must transfer, without consideration, its right to share in the proceeds of the sale of G.C.T. real property, or its power to consent or withhold

its consent to such sales by Penn Central, or to retain all or a portion of the $5.6 million annual income flow and to hold instead that valuation on the basis of a hypothetical liquidation involves a forfeiture of all these rights and that such forfeiture is one hundred per cent certain, effects an unconstitutional taking of the property of the New Haven. This taking is all the more objectionable since the New Haven's valuable rights were passed on to Penn Central, a private corporation organized for profit, in order to assist it in meeting burdens imposed only temporarily by the Commission and of which it is being almost immediately relieved by the states.*

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Since 1964, the G.C.T. properties have thrown off substantial "excess income" and the courts have recognized that the New Haven is entitled to 50% of that excess income. In the Remand Report the Commission fixed the amount due for 1964, 1965 and 1966 (334 I.C.C. at 38-39; pp. 125a-126a) and both courts agreed on the amounts owed for 1967 and 1968 (p. 309a; p. 449a). Although both courts recognized that Penn Central had withheld monies past due and owing to New Haven, they nevertheless neglected to direct the computation and payment of interest. The interest should be computed at the legal rate prevailing for New York State. The amount is substantial.

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* The Special Master has commented: "Technically speaking, this is not a condemnation proceeding but, in a number of respects, it is analogous thereto. * * * This is not a proceeding in the Court of Claims but the Constitution binds the Reorganization Court as well and that means that private property cannot be taken for a public use (railroads are affected with a public interest and empowered to condemn for that reason) without payment of just compensation. I doubt that this constitutional requirement is met by leaving the determination of questions of value entirely to the Commission, particularly under circumstances where it is confronted with a deep conflict of interest between its functions in discharging this duty." (Spec. M. Rep. p. 45, R. Doc. #59)

IV

The Commission's computation of the discount of net liquidation proceeds to present value was arbitrary and capricious.

Throughout these proceedings the Commission reports have unhappily evidenced that the Commission is unable or unwilling to comprehend either the theories of commercial discounting or the mathematical application of those theories.

In the Inclusion Report, the Commission failed to discount the projected liquidation expenses (289 F. Supp. at 427-28; pp. 331a-332a), failed to discount the value of bonds used to pay part of the purchase price (289 F. Supp. at 437-38; p. 353a), failed to discount the cost of the bonds to be delivered (289 F. Supp. at 439; p. 356a) and failed to discount the cost of the assumption of the Boston & Providence R. R. mortgage (289 F. Supp. at 439; p. 356a).

In the Remand Report, the Commission misconceived the nature of a valuation arrived at by application of a capitalization rate to income (p. 422a and 304 F. Supp. at 806-07; p. 295a), failed to discount the value of assumption of the Harlem River Division mortgage (428a) and failed to adjust its original figure for the discount of proceeds to reflect the subsequent changes in method and values resulting from the decisions of the courts (p. 427a and 304 F. Supp. at 810-11; pp. 302a-303a).

In their opinions upon review of the Remand Report, both the Statutory District Court (p. 427a) and the Re-

organization Court (304 F. Supp. at 810-11; pp. 302a-303a) asked the Commission to recompute the discounts and submit the compuation on settlement of the respective decrees.* The Commission by letter dated June 10, 1969 to the Reorganization Court made a recomputation (Exh. to R. Doc. #80) to which the bondholders responded that the Commission's recomputation was not in accordance with the Reorganization Court's direction that the Commission file "a new formulation and recomputation of the discount for the present value of the New Haven's liquidation proceeds, in accordance with generally recognized accounting principles and based upon the changes made in valuation items through and including those stated in the present opinion." (304 F. Supp. at 810-11; pp. 302a-303a). The bondholders pointed out (Cert. R. Doc. #64) that the Commission's computation omitted corrections to the Inclusion Report, at the hearings on remand, as to which *both the bondholders' and Penn Central's discounting experts had agreed.*

The order of the Reorganization Court recognized that the correction of these errors required an increase in the price to be paid by Penn Central of $2,415,899.** (304 F. Supp. at 1137-38; p. 318a).

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* The Statutory District Court also directed the Commission to calculate the discount of the value of assumption of the Harlem River Division mortgage (pp. 428a-429a). The Commission responded by issuing its Fifth Supplemental Report on July 10, 1969. The discount was, however, computed incorrectly and on reconsideration, the Commission issued a new "modified" Fifth Supplemental Report which recomputed the discount and finally arrived at the correct dollar amount of the discount (pp. 222a, 224a).

** This figure includes a correction of $130,000 for errors conceded by the Commission in its June 10, 1969 letter.

The bondholders called these errors and the Reorganization Court's order to the attention of the Statutory District Court. The majority of the Statutory District Court, in a memorandum accompanying its decree stated:

> "We have not passed on the merits of this contention since we do not consider it to be appropriately before us on settlement of the decree. The difference in the treatment of this item by the two courts will be another matter for ultimate resolution by the Supreme Court". (p. 445a)

Had the Statutory District Court considered the matter and applied to the final price determined by the majority the basis for correction of the discount urged by the bondholders and accepted by the Reorganization Court, the correction would have amounted to $2,695,899 instead of $410,000.*

The Commission's post-decision recomputations of the discount to present value as submitted to both courts fail to correct four errors. Three of the errors favored Penn Central and one the New Haven.

(a) The Commission, to New Haven's detriment, included in the gross receipts to be discounted $8,177,633 which is never to be received.

As previously mentioned in other sections of this brief, the Commission approved a discount of $8,177,633 from the value of property unsold at the end of four years on the

* The Commission recomputation is correct as to the items it recomputed. It did not recompute all of the items requiring recomputation. The difference between the correction of $130,000 the Commission recalculated on the basis of the opinion of the Reorganization Court and the $410,000 correction submitted by the Commission to the Statutory District Court arises from the difference between the courts in respect of their treatment of the Harlem River and Oak Point yards.

grounds that a forced sale would be necessary to accommodate the assumption of a six-year liquidation period (331 I.C.C. at 662; p. 20a; 289 F. Supp. at 428 fn. 6; pp. 332a-333a). In the Inclusion Report, the Commission only discounted the anticipated receipts and did not discount the projected expenses; the courts found this to be error (289 F. Supp. at 427-28; pp. 331a-332a). The error was probably caused by the fact that the Commission relied on the testimony of Mr. Gordon, who testified as to a discount figure for receipts but did not testify as to a discount figure for expenses. Mr. Gordon's method of treating the $8,177,633 "write-down" of land values was to include the full, undiscounted value of the land as a "receipt" (Tr. 23420, R. Doc. # 109) and include the $8,177,633 "write-down" as an expense of liquidation.

When the Courts held that the Commission had failed to compute the discount correctly because it had failed to discount the liquidation expenses, both the bondholders and Penn Central offered expert testimony at the remand hearings. The bondholders presented the testimony of Dr. Altman (R-39, R. Doc. #50) and Penn Central presented the testimony of Mr. Hull (R-38, Cert. R. Doc. #50) in respect of the correct amount of the discount to both receipts and expenses.* As the $8,177,633 was never *actually* to be received and then expended, *both witnesses* eliminated the $8,177,633 in computing and discounting receipts and eliminated the $8,177,633 as an expense of liquidation. The Commission adopted the testimony on remand *as to the*

* Dr. Altman's computations were based upon the testimony of the Trustees' witnesses and earlier testimony of Mr. Hull (NHI-93, R. Doc. #121) as to the time when the New Haven would receive various of the liquidation proceeds; Mr. Hull's testimony was based upon the testimony of the Trustees' witnesses, with modifications based upon new assumption of his own as to the timing of the receipt of certain proceeds.

discounts of expenses, but held to Mr. Gordon's discount of receipts (334 I.C.C. at 40; p. 127a). As a result, the Commission has discounted the *receipts* as if the $8,177,633 were to be received (consistent with Mr. Gordon) but discounted the *expenses* without including the $8,177,633 among the expenses (contrary to Mr. Gordon).*

While a correct result is reached by treating the $8,177,633 both as a receipt and then as an expense, as Mr. Gordon did, or by treating the $8,177,633 as never having been received and therefore neither a receipt nor an expense, as Dr. Altman and Mr. Hull did, it *cannot* be correct to treat the $8,177,633 as having been received, but not expended, which is the effect of the Commission's computation. Although the Commission has taken a discount on the $8,177,633 of "phantom receipts", it has never taken a discount on the $8,177,633 which *must* be treated as a liquidation expense during the fifth and sixth years, when the "write-downs" from land value occur. The Commission's recomputation ignores the evidence and perpetuates the error of overstating the discount of net proceeds to present value by $2,066,488 ($8,177,633 x .25270, the discount factor for the fifth year). There can be no real dispute as to this mathematical error; there was no evidence, because there could be no evidence, to support the Commission's error.

* The Commission was apparently under the impression (found by both courts to be erroneous) that Mr. Gordon's discount of receipts was not a discount at all, but an absolute dollar deduction of $17.6 million (334 I.C.C. at 53; p. 140a). The Commission's stubbornness on the point, in the face of evidence as to which both sides agreed, is reflected in several footnotes in the Remand Report (334 I.C.C. at 40 fn. 17, 60 fn. 34, 63 fn. 37; pp. 127a, 147a, 150a). The Commission adopted the witnesses' discount of expenses without examining or without understanding it and therefore irrationally went on to conclude "It is unnecessary to consider the differences between the parties' discounts of the proceeds, since we see no error in our prior opinion on this point." (334 I.C.C. at 40 fn. 17; p. 127a).

(b) The Commission, to New Haven's detriment, included salvage costs of $17,591,589 in the gross receipts to be discounted but omitted that amount from the expenses to be discounted.

The same failure to examine "both sides" of the discounting procedure—receipts and expense—that led to the erroneous calculation of the $8,177,633 item, detailed above, led the Commission into another error. Mr. Gordon arrived at the liquidation values of road property (ties, rails and the like) by finding the gross receipts from the sale of salvaged material and the amount of the expenses required to tear up the road property so as to make it available for sale. As previously mentioned, Mr. Gordon only testified as to the discount to present value of gross receipts and did not testify as to the discount of the salvage expenses.

The Commission adopted as firm Mr. Gordon's discount of gross receipts and looked to the evidence presented by both the bondholders and Penn Central only with regard to the discount of expenses. Mr. Gordon's discount of receipts did not take the salvage expenses into account, but both Penn Central and the bondholders recognized that the salvage expenses had to be reflected in calculating the correct discount. Dr. Altman and Mr. Hull reflected the expenses, not by including them as expenses, but by reducing the amount of receipts before application of the discount factors. Of course, the same result could have been achieved by using the amount of gross receipts without regard to the salvage expenses as per Mr. Gordon, and then including the salvage expenses among the liquidation expenses to be discounted. The Commission, however, has used the gross receipts without deducting the salvage expenses (as per Mr. Gordon) but, by adopting only "one

side''—expenses—of the witnesses' testimony, the Commission failed to include the salvage expenses in computing the discount of liquidation expenses. The amount of the salvage expense involved is $17,591,589.* All of the expense items which go to make up the $17,591,589 may be found in the valuations of ''road properties other than land'' (NHI-4 pp. 12, 32, R. Doc. #119).** The Commission's recomputation ignores the evidence and perpetrates the error of overstating the discount of net proceeds to present value by $1,474,057.† There can be no real dispute as to this mathematical error; there could not be and was no evidence to support the Commission's error.

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* Penn Central's exhibit R-38 (Schedule A, R. Doc. #50) shows net receipts from "Other Road Property" (gross receipts from sale of salvaged material less expenses of tearing up road property) of $36,239,600 ($38,879,600 reduced by $2,640,000 to reflect an adjustment required by the Inclusion Report). Mr. Gordon computed his discount on the basis of gross receipts of $56,471,189 for "Other Road Property", an excess of $17,591,589 over the comparable net receipts of $38,879,600.

** The treatment of the liquidation of railroad ties may be seen as one example of the items going to make up the $17,591,589. Mr. Gordon valued the ties at $1.75 and $2.00 per tie and estimated the expense of removing the ties at $1.00 per tie (NHI-42 p. 32, R. Doc. #119). The Commission has computed the discount to present value on the basis of the $1.75 and $2.00 receipts (resulting in a greater subtraction from receipts) but has failed to include the $1.00 of salvage expense in computing the discount of expenses (resulting in a smaller subtraction from expenses).

† Assuming the proceeds of sales are received in the same year the salvage expenses are paid the computation is as follows:

	Overstatement	*Discount Factor*	*Overstatement of Discount*
First Year	$ 5,863,863	.02913	$ 170,814
2nd Year	5,863,863	.08486	497,607
3rd Year	5,863,863	.13739	805,636
	$17,591,589		$1,474,057

The above errors, both of which result from the same mathematical and conceptual omission on the part of the Commission, result in an over-discount of $3,540,545, improperly favoring Penn Central in that amount.

(c) Timing error to New Haven's detriment

The undisputed evidence showed that certain real property which was separately valued at $1,837,000 (NHI-45 p. 32, R. Doc. #119) was "readily saleable" and would be disposed of in from one to one and one-half years (Tr. 23535-37, R. Doc. #110). The Commission nevertheless treated the proceeds from sales of this real estate as receivable over a period of six years, resulting in an understatement of the discount of net proceeds in the amount of $118,000.

(d) The Commission, to Penn Central's detriment, failed to discount certain receipts from sales of equipment, materials and investments.

In addition to the errors specified above which favored Penn Central, the Commission also made an error in favor of the bondholders which amounted to $1,372,646.

The liquidation study projected receipts from the sale of equipment, investments and materials in the total amount of $47,121,400.* The Commission failed to apply any discount to present value as to these proceeds, presumably on the grounds that these assets are so readily saleable that no discount is appropriate. Both Dr. Altman for the bondholders and Mr. Hull for Penn Central, however, believed

* The $47,121,400 consists of Equipment ($22,651,800), Investments ($20,388,800), Materials and Supplies ($2,088,200) and Account 741 Assets ($1,997,600) (NHI-42 pp. 8, 13, R. Doc. #119).

that some discount was appropriate (R-38, R-39, R. Doc. #50). There was, however, a dispute; Dr. Altman based his calculations on the receipt of most of these proceeds during the first year and Mr. Hull assumed the receipts would be over the first three years.* Mr. Gordon had testified that the equipment could be sold in the first year (NHI-42 p. 40, R. Doc. #119). The Commission, in its submission to the Reorganization Court (Exh. to R. Doc. #80), made its calculations on the basis of the sales of equipment and investment being made in the first year. The result reached by the Reorganization Court shows that although the Commission had disregarded the testimony of both the Penn Central and bondholders' witnesses and had taken no discount on these receipts, the Reorganization Court concluded that the evidence required a discount on the assumption of receipts being spread over the first year. The amount of that discount, as found by the Reorganization Court, is $1,372,646 ($47,121,400 x .02913).

* * *

The Reorganization Court's corrections of the discount to present value resulted in a conclusion that Penn Central is required to pay an additional $2,415,899.** The Statutory

* Mr. Hull had earlier treated these receipts as first year receipts (NHI-93 p. 39, NHI-93A p. 39, R. Doc. #121).

** This figure is the result of the following corrections:

In favor of the New Haven:	
(a) Correction re $8,177,633 item	$2,066,488
(b) Correction re $17,591,589 expenses	1,474,057
(c) Correction re real estate sales	118,000
	$3,658,545
In favor of Penn Central:	
(d) Less: correction re $47,121,400 receipts	1,372,646
	$2,285,899
Plus corrections computed by Commission	130,000
Total	$2,415,899

District Court chose not to make the corrections, not from a conviction that the errors did not call for correction, but because it did not "consider it to be appropriately before us on settlement of the decree" (p. 445a). In its decree, the Statutory District Court accepted the Commission's recomputation which required payment of an additional $410,000 to the New Haven (p. 448a).*

The Statutory District Court appears to have assumed the issue of the discount would be briefed to this Court for resolution. Since the decree of the Statutory District Court and the order of the Reorganization Court differ, it is entirely appropriate for the issue to be resolved here. The Reorganization Court's treatment of these mathematical errors is correct and should be affirmed.

V

The Commission's valuation of the New Haven's Harlem River and Oak Point freight yards was arbitrary and capricious.

The New Haven owned approximately 160 acres of land located at the southernmost tip of the Borough of the Bronx in the City of New York, bounded by the Harlem and East Rivers (289 F. Supp. at 433; p. 344a).** The property is used for commercial warehousing, industry and railroad freight yards and includes six commercial buildings with space rented to commercial and industrial

* See footnote p. 133, *supra*.

** An aerial photograph of the property appears in the front of exhibit NHI-95 (R. Doc. #122). The property is immediately adjacent to the under-utilized 284 acre Randall's Island Park recreation facilities (Tr. 27333-38, R. Doc. #117).

tenants as well as railroad freight yard buildings and facilities. The Reorganization Court held the Commission arbitrarily valued this property at $4,439,000 less than its fair value.

Because this property is vast and of very substantial value, separate independent expert testimony was presented by the Trustees (McCann), Penn Central (White), and the bondholders (O'Keefe). All told, the three experts presented four different industrial use appraisals and one appraisal on the basis of residential use. (289 F. Supp. at 433; pp. 344a-345a).*

Mr. McCann, for the Trustees, appraised the property on June 15, 1965 (NHI-52, 53, R. Doc. #119) and on December 31, 1965 (NHI-51, R. Doc. #119). The June 15, 1965 appraisal resulted in a valuation of $22.65 million and the December 31, 1965 appraisal resulted in a valuation of $18.1 million. In the Inclusion Report, the Commission chose the $18.1 million appraisal (331 I.C.C. at 668; p. 26a) and treated the higher appraisal as having been based upon the use of the property as railroad yards in the hands of the New Haven (331 I.C.C. at 685; p. 43a). On review of the Inclusion Report, the Statutory District Court remanded the issue for a "reasoned explanation" (p. 386a) and stated:

"* * * we find no adequate explanation in the Report for the rejection of the higher of the two estimates

* The appraisals were:

McCann (first appraisal)	—	$22.65 million
McCann (second appraisal)	—	18.1 million
O'Keefe (industrial use)	—	26.0 million
O'Keefe (residential use)	—	32.0 million
White (industrial use at forced sales)	—	15.59 million

> submitted by Mr. McCann, * * * the agency indicated its belief that the earlier and higher McCann study was based upon the assumption that *the properties were to be continued to be used as railroad yards* * * * an examination of the earlier study itself indicates that *it was not in fact made on that basis* but instead assessed the property's 'Fair and Reasonable Market Value' to industrial users" (289 F. Supp. at 434; p. 344a) (emphasis added).'

In the Remand Report, the Commission adhered to the lower appraisal of $18.1 million, stating perversely in the light of court's opinion quoted above "the three-judge court is correct in its understanding that the trustees' appraisal of June 15, 1965, was based upon an assumption that the properties involved *were to be continued in use as railroad yards*" (334 I.C.C. at 42; p. 129a) (emphasis added). The Commission went on to state:

> "This point was clarified at the further hearing in the testimony that the $22.7 million appraisal of the yards was made on the basis that they *were operating railroad properties* with facilities for shippers and tenants to be served by railroad * * *.
>
> The further hearing following remand also confirmed the fact that the $18.1 million appraisal we accepted was based on the assumptions that NH's railroad had ceased to exist, *its tracks were removed from the yards, power was shut off leaving the yards without electricity and power, and the properties had become industrial facilities without any railroad service.*" (334 I.C.C. at 42; p. 129a) (emphasis added).

The Commission considered its choice between the two appraisals to be governed by the method of valuation chosen. After setting forth its assumptions as quoted above, the Commission stated:

> "No other method of liquidation was considered, or remanded to us for considefation by the courts, or previously raised before us by the parties * * * the creditors have raised the question whether it should always be assumed that in the event NH is liquidated, its tracks would be removed from the yards and its buildings and land sold as nonrailroad-served real estate, or whether it should be assumed that upon liquidation, the two yards *would be sold,* as is, *to another railroad for continued operation*" (334 I.C.C. at 43; p. 130a) (emphasis added).

The Commission has misunderstood Mr. McCann's appraisal and testimony, misunderstood the reason for the remand in the first instance and misunderstood (or at least misdescribed) the argument urged by the creditors, resulting in an incorrect and inconsistent choice of valuation methods. The creditors were *not* contending for a valuation based upon a "sale to another railroad for continued operation"; the then majority of the Statutory District Court (Judges Friendly and Weinfeld) did *not* understand that the higher McCann appraisal "was based on an assumption that the properties involved were to be continued in use as railroad yards"; that was the understanding of the *dissenting judge* on this point (Judge Levet).* The majority, on the basis of its own examination of the McCann appraisal, was questioning the soundness of the *Commission's* understanding of the appraisal. The bondholders were contending for a method of appraisal which treats

* The remand of the Inclusion Report on this point was directed by Judges Friendly and Weinfeld with Judge Levet dissenting on the ground that Mr. McCann's higher valuation "was based *not* on liquidation value but on the value to an operating railroad" (289 F. Supp. at 450; p. 380a) (emphasis in original). On review of the Remand Report, Judges Friendly and Levet bowed to the Commission's "expertise" on this issue (p. 423a) and Judge Weinfeld dissented (pp. 442a-443a).

the property, not as a wasteland produced by misconceptions of the effects of a hypothetical liquidation, but as ordinary, Bronx industrial property, with railroad service proximate to the area.

The bondholders have contended that ordinary railroad service would be available to the area because, even if the New Haven is liquidated, there is another railroad now providing service to the area. It is Penn Central, but the principle involved would apply to any other railroad. In the valuation of the Harlem River and Oak Point Yards, the Commission, for the first and only time in this proceeding, not only assumed the liquidation of the New Haven, but that services normally available from others, such as electricity, power and railroad service (334 I.C.C. at 42; p. 129a), would be unavailable. The liquidation assumption did not require an assumption that the Bronx was to be liquidated along with the New Haven.

On remand, Mr. McCann testified that his first (and higher) appraisal was based upon his opinion of the "fair and reasonable market value of the property" (Tr. 28847-8, R. Doc. #47). He assumed a willing seller and a "hypothetical willing industrial buyer based on industrial uses that were common throughout the Bronx" (Tr. 28877-8, R. Doc. #47). He did *not* appraise the properties for use as railroad yards or for sale only to another railroad. He merely assumed that railroad service to the property such as that now furnished by the New Haven would be available for the industrial shippers, tenants or purchasers of the property (Tr. 28848-9, R. Doc. #47). The Commission's understanding of the valuation method used by Mr. McCann in his first appraisal was absolutely incorrect.

On the remand hearing, Mr. McCann testified that, in making his second appraisal he *was unaware* of the undisputed fact that a physical connection and interchange existed between the Oak Point Yard and the Port Morris branch of Penn Central (Tr. 28881, R. Doc. #47). He assumed, therefore, for his second appraisal, that upon liquidation of the New Haven, no ordinary rail service would be available for use by industrial occupants of the Harlem River and Oak Point Yards (Tr. 28862, R. Doc. #47). He therefore reduced his appraisal of the land by 20-50 cents per square foot, based upon his experience that Bronx industrial property with rail service available to it received a premium over property with rail service unavailable, of about 10% (Tr. 28854, R. Doc. #47).* When Mr. McCann explained his mistake as to the proximity of Penn Central's Port Morris Line** the Commission permitted a partial inquiry as to the future availability of services to the property.†

Mr. White, an independent realtor who appraised the property and *testified on behalf of Penn Central,* stated:

> "It seems unlikely that termination of the New Haven's railroad service would have a really depressing effect on the location under consideration. The New York Central Railroad's Port Morris freight yard is

* Mr. McCann adjusted the value of the improvements in a similar manner (Tr. 28850-54, R. Doc. #47).

** Referring to Mr. McCann's second appraisal, the Commission stated: "No consideration was given in this appraisal to the interchange connection with Penn Central's Port Morris branch via trackage extending from the Oak Point yard." (334 I.C.C. at 42; p. 129a).

† In respect of all the real estate appraisals other than the Bronx yards, the availability of services (including the availability of rail service) and its effect on market value, was left to the expert real estate appraisers (331 I.C.C. at 667; p. 25a).

less than 300 feet away from the New Haven's Oak Point yard and is less than 3000 feet from the Harlem River yard. Industries needing railroad service would, doubtless, continue to get that service." (NHI-95 p. 3, R. Doc. #122).

As noted by the Reorganization Court (304 F. Supp. at 807-8; p. 297a) and by the Commission (334 I.C.C. at 43-4; pp. 130a-134a), the railroad tracks running to and through these yards are the connecting freight traffic link to New York City's new multi-million dollar Hunts Point Market, the distribution center for most of the produce necessary to feed New York City. Mr. Weaver, testifying on behalf of Penn Central, admitted that if New Haven operations ended, New York City would have to make sure that railroad service was provided to Hunts Point Market and that "someone" would acquire access to rail service for the Hunts Point Market (Tr. 29445-6, R. Doc. #48). The bondholders' witness testified that "rail service into and through this area would undoubtedly continue even if the New Haven were liquidated, in view of the large volume of existing and potential traffic in the vicinity" (R-16 p. 2, R. Doc. #50).

Despite this testimony from both sides, despite the fact that the 50 industrial customers now in the Oak Point and Harlem River area *now* receive more than 100 cars per day (R-16 pp. 6-7, R. Doc. #50) and at least 2000 cars per month are received by New Haven from Penn Central destined solely for the Hunts Point Market, despite the clear public interest in continued service to the Hunts Point Market, despite the fact that Penn Central's line runs right to the edge of the Oak Point Yard and despite the evident power of New York City and State over Penn Central in

the area of subsidies and taxes, the Commission proceeded to value on the assumption service would not be furnished by Penn Central. It apparently placed the burden of proof upon the bondholders to show that after the 160 acres have been industrially developed, rail service to the area will be profitable. The Commission stated:

> "The record does not support any finding of substantial need for Penn Central service that would justify the construction by that carrier of the trackage necessary to connect Harlem River and Oak Point yards and the latter yard and Hunts Point, if NH were to be liquidated." (334 I.C.C. at 47; p. 134a)

But the record does not show, and Penn Central did not offer, the projected cost of the construction of track to replace the New Haven track that is there now.* As a result, the record is also bare of support for the Commission's implicit finding—that such construction is financially unjustified. The demands of the Hunts Point Market and the demands of the industrial shippers now in the area and projected for the 160 acres are evidence as to "substantial need". By statute, it is the duty of every common carrier "to provide and furnish transportation upon reasonable requests therefor" 49 U.S.C. §1(4) and to provide switch connections and cars for traffic to branch lines or private side track constructed by a shipper to connect with the railroad 49 U.S.C. §1(9).

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* No proof whatever was required. The New Haven, on an assumed liquidation would not depreciate its real estate by 10% but would donate, if need be, the necessary trackage, avoid the expense of taking up rails, ties and associated facilities and preserve the character of the real estate as industrial property with ordinary rail access. It is irrational to suppose that the Commission would not condition an abandonment certificate on New Haven's offering such track to New York City, the industrial users, or Penn Central.

The Commission stated:

> "Nor is there any evidence that the expenditures necessary to correct clearance deficiencies on the Port Morris branch would be warranted by the revenues resulting therefrom." (334 I.C.C. at 47; p. 134a)

Neither Penn Central nor the bondholders presented evidence of the amount of "expenditures necessary" or evidence as to the amount of the revenues to be anticipated. As a result, there was no evidence that the expenditures were economically unfeasible.

From the above recitals of the total *absence* of evidence, the Commission found:

> "On this record, and the assumption of NH's liquidation and the dismantling of its system, Penn Central would not serve, and could not be compelled to serve, the Harlem River or Oak Point industries, or the Hunts Point Market." (334 I.C.C. at 47; p. 134a)

On this record, the only evidence that Penn Central "would not serve" was the unsupported statement of a Penn Central operations manager, who had made no study of potential traffic (Tr. 29449-51, R. Doc. #48) and who had only looked at an undisclosed study of the present perishable produce traffic (Tr. 29421, 29449) that he would not recommend that Penn Central be interested in purchasing the spur track connections for a price which he mistakenly believed to be equal to the price for the entire 160 acres (Tr. 29460-61, R. Doc. #48).

The only material relied upon by the Commission as to the profitability of providing service to the area was a 1965 cost study applicable generally to all traffic of perish-

ables in the East (334 I.C.C. at 46; p. 133a). The study was not placed into evidence by the Commission's Bureau of Accounts and the first time any counsel for the bondholders was informed that the study existed, would be used, or had anything to do with this case was when it appeared in the printed Commission report. Every rule or concept of fair procedure has been violated by the insertion of this study as a basis for decision. In addition, the study contains footnotes and cross-references to what is apparently a larger study referred to as "statement No. 1-68", which does not appear and which was not offered or placed into evidence in this case. Further, it should be noted that the 1965 study, described by the Commission (in November 1968) as its "most recent data", predates the establishment of the centralized, modern Hunts Point Market and is completely irrelevant.

To the Commission, this array of "non-evidence" sufficed to enable it to conclude:

> "It also seems unlikely that rail service by a carrier other than Penn Central would be performed in the yards if NH were liquidated." (334 I.C.C. at p. 47)

The supposed support for this conclusion is the bondholders' failure to offer estimates of the "costs of rehabilitating the bridges or the revenues which would be derived from the operation"; the bondholders' failure to determine "the profiitability of the yard traffic to harbor carriers or whether any of the harbor carriers are interested in the traffic" and the financial inability of the New York Connecting Railroad (which Penn Central's witness erroneously assumed would be torn down as part of the New Haven liquidation) (Tr. 29441, R. Doc. #48) "to acquire

NH's yards and their appurtenant facilities." (334 I.C.C. at 47; p. 134a) The same faulty understanding is carried on to the following conclusion:

> "There is nothing in the record to establish that any existing terminal carrier is interested in acquiring the NH yards, that any serious consideration is being given to the formation of a new terminal carrier to do so, or that the city of New York is interested itself in *acquiring the yards for continued operation.*" (334 I.C.C. at 47; p. 137a) (emphasis added)

No one suggested that Penn Central, New York Connecting, a terminal carrier or the City of New York, would have to purchase the *yards;* they would only have to purchase a small piece of interchange track valued at less than $500,000 (NHI-51 pp. 10, 11, 13 in part, R. Doc. #119)—and provide the service. If necessary, the track would have been donated. The yards would be sold to industrial users. Since it was known Penn Central was to take all of New Haven's assets, it is neither rational nor fair for the Commission to place reliance on the fact that existing terminal carriers or others had not *actually* expressed interest in a purchase. The requirement that administrative decisions be based upon substantial evidence and reasoned findings, has "become lost in the haze of so-called expertise." *Baltimore & Ohio R.R. Co.* v. *Aberdeen & Rockfish R. Co.,* 393 U.S. 87, 92 (1968).

Especially where it is clearly shown that the Commission confused its methods of valuation and failed to understand the methods of valuation used by the appraiser, the Reorganization Court has substantial responsibility to make certain that the Commission considered the facts

relevant to a proper valuation. See *Ecker* v. *Western Pacific R. Corp.*, 318 U.S. 448, 477 (1943). The Reorganization Court has determined that the Commission failed to take the relevant facts into consideration in determining its valuation method and its conclusion that no rail service would be provided to the area was not supported by substantial evidence (304 F. Supp. at 807; p. 296a). Judge Weinfeld came to the same conclusion (pp. 442a-443a). In fact, the evidence was entirely the other way; there was *no* evidence to support the Commission's conclusion. The Reorganization Court concluded:

> "To assume that the State and City of New York would stand idly by and permit the life line to its huge and costly enterprise to be cut, just as it is in the midst of planning its necessary enlargement, because it was unwilling or unable effectively to bring pressures to bear or take steps on its own to preserve the connection with Penn Central is absurd, even if the I.C.C. continues its policy of forcing the railroads to handle perishable produce at a loss" (304 F. Supp. at 808; p. 297a).

The Reorganization Court's position is unassailable.*

In any event, the New Haven is entitled to receive the "highest and best use" for its property (p. 417a) which must take into consideration the reasonably prospective use for the property. *McCandless* v. *United States* 298 U.S. 342, 345 (1936). In *Boom Co.* v. *Patterson*, 98 U.S. 403 (1878) it was clearly recognized that market value of

* It should be noted the majority of the Statutory District Court, while writing an opinion notable for its deference to the substantial evidence rule, did not uphold the Commission on the grounds that its conclusion in this area was supported by substantial evidence, but on an expressed deference to the Commission's "expertise". But see *Burlington Truck Lines* v. *United States*, 371 U. S. 156, 167 (1962).

property must encompass "the uses to which it is plainly adapted; that is to say, what it is worth from its availability for valuable uses" (98 U.S. at 408). Surely, the application of this legal standard compels the adoption of the higher McCann appraisal. The value of the Harlem River and Oak Point Yards is $4,439,000 more than the figure arbitrarily fixed by the Commission.

VI

The Commission violated the Fifth Amendment by requiring the transfer to Penn Central of non-operating property without the payment of any consideration for such transfer.

The New Haven was, prior to December 31, 1968, the owner of 91,344 shares of the common stock of Railway Express Agency, Inc. (REA). (NHI-30 p. 15, R. Doc. #119). Penn Central's petition for approval of the inclusion valued the equity of the REA shares at $766,155. Because of the absence of a ready market for these shares and uncertainties created by litigation and recent legislation, a witness testified that the shares had no market value in an assumed liquidation.* (NHI-42 p. 9, R. Doc. #119). The Commission, without comment, attributed *no value* at all to the shares (331 I.C.C. at 678; p. 36a), *but nevertheless required their transfer to Penn Central.*

The New Haven also was the owner of 15,000 shares (50%) of the common stock of New York Connecting Rail-

* This was despite the fact that at the time of the testimony, an offer of $20 per share was oustanding. See *Denver & Rio Grande R.R. Co.* v. *United States,* 387 U. S. 485 (1967). At that price, the shares would be worth $182,688.

road Company. Although the shares had a book value of $1,527,204 (NHI-30 p. 15, R. Doc. #119) and a shareholders' equity of $1,117,415, the Commission attributed *no value* at all to the shares *but nevertheless required their transfer to Penn Central* (331 I.C.C. at 678; p. 36a).

The REA shares and the New York Connecting Railroad shares are not railroad operating properties but investments and their transfer without consideration is unnecessary to Penn Central's assumption of New Haven railroad operations. The transfer of these shares to Penn Central without attribution of value unconstitutionally deprives the bondholders of their property and provides a windfall to Penn Central. Neither the Commission nor any party to these proceedings* has suggested any justification for a transfer of these non-operating assets without consideration and there is no need for their transfer at all. Since the Commission is unable to determine the market value of these securities, they must be retained by the New Haven estate. If the Commission is correct in holding these investments valueless, it cannot at the same time argue their retention by the New Haven deprives Penn Central of something of value.

Both REA and New York Connecting Railroad continue to conduct business. Even if, at a hypothetical liquidation auction, no offers were received for these shares, a reorganization court would not permit them to be abandoned. They would, in the ordinary case, be distributed to the creditors. In the case of the New Haven, they should be retained by the reorganized company.

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* Although the issue had been raised in briefs to the Courts, neither Court has specifically commented on the question.

Conclusion

For the foregoing reasons, the decree of the Statutory District Court should be reversed and remanded for modification in accordance with the objections presented in the appeals of the Bondholders Committeee and Manufacturers Hanover Trust Company, as Trustee. The order of the Reorganization Court should be reversed and remanded for modification in accordance with the objections presented in the petitions of the Bondholders Committee and Manufacturers Hanover Trust Company, as Trustee. The Statutory District Court and the Reorganization Court should be directed to remand the reports and orders of the Commission with instructions to modify the Fourth Supplemental Report and Order in accordance with the specific directions of this Court.

Respectfully submitted,

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